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153018
No. 15315.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

M. W. ENGLEMAN, as Assignee for the Benefit of Creditors Generally of Campagnola Food Products, Inc., a Corporation,

Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a Corporation,

Appellees.

APPELLANT'S OPENING BRIEF.

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Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a Corporation,

Appellees.

APPELLANT'S OPENING BRIEF.

Introductory Statement.

This is an appeal from a judgment of dismissal [38-40] by the trial judge, under Rule 41(b), in a jury case, at the conclusion of the plaintiff's case in chief, and before the introduction of evidence by the defendants [208-211].

Jurisdictional Statement.

The jurisdiction of the District Court is founded on diversity of citizenship and amount [3, 8]. 28 U. S. C. A. 1332(a)(1)(2).

The plaintiff is a citizen of California [20, 25], and the defendant, General Accident, is a corporation incor-

porated under the laws of Great Britain [3, 20]. The defendant, North American, is a Pennsylvania corporation [8, 25].

The amount in controversy in each case exceeds \$3,000.00, exclusive of interest and costs [4, 9, 20, 25].

This court has appellate jurisdiction under 28 U. S. C. A. 1291, 1294 to review the judgment of dismissal entered against plaintiff in these consolidated cases.

United States v. Wallace & Tiernan Co., 336 U. S. 793, 794-795, 69 S. Ct. 824, 825, 93 L. Ed. 1042, 1047 (1949);

Wecker v. National Enameling & Stamping Co., 204 U. S. 176, 181-182, 27 S. Ct. 184, 186, 51 L. Ed. 430, 434 (1907);

United States v. Shelley, 218 F. 2d 157, 158 (2nd Cir. 1954);

6 Moore's Federal Practice 114.

See also

Mitchell v. Board of Governors of Washington State Bar Assn., 145 F. 2d 827 (9th Cir. 1944); cert. den. 324 U. S. 845, 65 S. Ct. 677, 89 L. Ed. 1407 (1945).

Questions Involved.

Was there sufficient evidence to warrant submitting to the jury the factual question of the existence of oral contracts between the plaintiff's assignor and the insurance companies? The oral contract in issue is an oral contract to increase Campagnola's fire insurance, in excess of the amount issued by the companies in previously written policies.

The question was raised when the plaintiff rested its case in chief [192-193], and the defendants, before in-

troducing any evidence, made a motion “to direct the jury to return its verdict in favor of defendants and each of them . . .” [193]; the trial judge, after pointing out that “motions for directed verdicts are obsolete in these courts” [209] considered the defendants’ motions as motions to dismiss [209] and granted the motions to dismiss [209], and the judgment of dismissal was entered [38-40].

Specification of Errors.

Appellant specifies as error:

- (a) The ruling of the District Court Judge that plaintiff had failed, on his own case, to show a right to relief.
- (b) The ruling dismissing the action.
- (c) The judgment of dismissal.

Trial Court’s Position on Dismissal.

First: re Agency: The trial judge agreed with the plaintiff that there was sufficient evidence on the question of Klee and Love being the agents of the defendant insurance companies to be a jury question; the court said during the argument:

(a) “The Court: For your information, Mr. Miller, I have no problem with the question of agency. I don’t mean to say that I decided the question of agency because it is a fact matter. I think there is sufficient evidence on the question of agency that it would be a jury question” [197-198].

(b) “The Court: I have told you, Mr. Miller, I have no question in my mind but what on the matter of agency there is a case for the jury” [204].

(c) “The Court: . . . I think the question of agency is one in which the plaintiff has made out a pretty good case; at least, a jury case” [208].

Second: re Oral Contracts: The trial court was of the view that the evidence would not warrant the jury finding that there were oral contracts with the two insurance companies for additional insurance in excess of that provided in the original policies; the district judge said:

(a) "The Court: . . . What bothers me is the question of privity here offer and of acceptance, as between the assignor to your claim and Mr. Love. 'What was offered? What was accepted? How, by what means? With what definiteness or lack of definiteness? How can we determine the terms that were struck, if your cause of action is to be maintained? We have to find a contract arrived at at that point, don't we?' " [204].

(b) "The Court: There is no doubt but that this case is not within the statute of frauds, and that an oral contract of the type which you contend was made here can lawfully be entered into and the courts enforce it.

"However, on the evidence in this case, I think that the evidence would not support a finding that such a contract was arrived at. There is still the requirement of the law that there be offer and acceptance, and that the heart or essence of the contract at least be clear, that a meeting of minds—what they taught us in law school under the name of privity of subject matter—must exist. The evidence here just doesn't spell that out" [208].

Statement of Facts.

Campagnola Food Products, Inc. (herein referred to sometimes as "Campagnola"), was a cannery with cannery equipment of substantial value.

Two separate policies were issued by the two defendant insurance companies on that equipment.

First, the defendant, General Accident, executed and delivered a fire insurance policy to Campagnola, plaintiff's assignor, on May 16, 1953 [Pltf. Ex. 6, 145, 146]; the property insured was Campagnola's equipment; the risk insured was fire; the amount of insurance was \$11,000.00; the policy was in effect to the time the action was commenced [4, 21].

Such policy was signed on behalf of Charles Richard Love, as agent for the defendant, General Accident [144-5]; clauses and endorsements appended to the policy also bore the name, Love, as agent for such defendant [145].

At the time of the policy issuance on behalf of General Accident, Love was an agent for General Accident [143; Pltf. Ex. 6], and had been such agent for General Accident from September, 1950 [143].

In November, 1952, sometime after the issuance of the General Accident policy, Love's agency for General Accident was terminated [143, 147]; there is no evidence that Campagnola was ever notified thereof.

On the other hand, after November, 1952 through August, 1954, Love continued to do business with General Accident in the name of his office associate, Klee [147], relative to Campagnola and others [148].

From the issuance of the policy to the time of the loss, Love handled renewals and others clauses in connection with the General Accident policy [147].

Klee was a general agent for General Accident at all times involved in this case, and even to the date of the trial [83; Pltf. Ex. 1, 85, Ex. 3; 111].

Love was associated in Klee's office for five years before trial [96]; he put through business as a subagent

after the termination of his agency with General Accident [102-103]; Love and Klee used each others agency facilities [102-103], and handled business on a "subagency basis" [102-103], thus enabling the general agent to have a substantial volume of business [102-103].

The statements from General Accident to Klee showed the business placed with that company by Love in Klee's name, and Klee made no objection [138].

Also, the defendant, North American, executed and delivered a fire insurance policy to Campagnola, plaintiff's assignor, on May 10, 1952; the property insured was Campagnola's equipment; the risk insured was fire; the amount of insurance was \$12,000.00; the policy was in effect to the time the action was commenced [9, 25].

From 1951, Klee also acted as general agent for the defendant, North American [95; Pltf. Ex. 2; 90].

Business was transacted by Love with North American that was charged to Klee's account [137], and Klee did not object to this [138]; the business transacted by Love with North American was handled in the name of his office associate, Klee, general agent for North American [148].

The evidence also shows that Love's acts with reference to Campagnola, in dealing with both defendants, were ratified by Klee and by the defendants themselves [104-109, 137, 138].

The trial judge was of the view and agreed with the plaintiff that there was sufficient evidence on the question of Klee and Love being the agents of the two insurance companies to warrant the decision thereon by the jury [197-198, 204, 208].

Love had discussed additional insurance with Campagnola on many occasions over a period of two years prior to the fire in this case [149]; on one occasion Esposito of Campagnola told Love that he was making a deal to do some refinancing in Campagnola, and if the deal went through they would probably want additional insurance [175].

On July 30, 1954, Friday [185], Love had a telephone conversation with Esposito, president of Campagnola, relating to additional insurance, and was told by Esposito to "go ahead and place that other \$50,000.00 of fire insurance which we discussed sometime ago" [149].

Love placed the additional \$50,000.00 as follows: \$14,000.00 with General Accident [157], \$15,000.00 with North American [158], and \$21,000.00 with a third company, Insurance Company of Pennsylvania, not involved in this case [158].

Love testified that in accord with the custom in the insurance business that the premium for the additional insurance would be at the same rate as the original policy [149-150], that the duration of the increased insurance ran to the expiration of the original policy term [159-160] and would commence as of the date shown upon the order or as of the date specifically requested [160-161], that the premium would commence the same way [161-162]; Love testified that on July 30, 1954, he knew Campagnola wanted the additional insurance on its equipment [163].

The request for the additional insurance was made on the telephone on Friday, July 30, 1954 [148, 149, 185]; the insurance companies were closed on Saturday, July 31, 1954 [185].

On Sunday, August 1, 1954, Love prepared two written memoranda [150-151]; Love testified that the dates August 3, 1954, on the memoranda were erroneous [153-154] and they were made on August 1, 1954 [151] and were mailed prior to 10 o'clock on Monday morning, August 2, 1954 [151, 153-154] in the mail box in the lobby of his office building [151] which was at Sixth Street and Grand Avenue, Downtown Los Angeles [142, 152-153].

General Accident itself then had its office in the Spring Arcade Building about 3 or 4 blocks from Love's office [190].

The insurance companies received Love's memoranda [151].

To General Accident, Love wrote [Pltf. Ex. 4; 152-153]:

"Date: 8-3-54.

"Will you increase your line by endorsement to \$25,000 part of total line of \$88,000. Advise immediately. DICK LOVE."

To North American, Love wrote [Pltf. Ex. 5, 153]:

"Date: 8-3-54.

"Will you endorse to increase your line to \$27,000, part of total line of \$88,000. Advise immediately. K. H. KLEE."

In sending these memoranda to the two defendant insurance companies, Love was following a practice which had, for some time, been accepted by the two insurance companies [147-148, 153, 180].

From August 2, 1954, to the date of the fire on August 7, 1954, Love received no communication, either by tele-

phone or letter, from either General Accident or North American informing him that either of them declined the risk [156-157].

Love testified that the custom and practice in the insurance business was that when an insurance company has a request for any type of coverage that they do not desire or positively will not issue, that they *at once* notify with a telephone call, followed by a written letter of declination [156].

In view of the custom and practice, and the two insurance companies not having informed Love or Klee of any delineation of the risk, Love relied thereon, considered the additional insurance effective with the defendants, and did not try to place it elsewhere [189-191].

It was admitted by the pleadings and at pre-trial that during the night of Saturday, August 7, 1954, the Campagnola insured equipment was destroyed and lost by fire to an extent substantially in excess of \$90,000.00 [5, 14, 55-56, 77].

It was admitted by the pleadings that on or about August 8, 1954, the day following the fire, notice was given to the two insurance companies of the fire and loss [5, 10, 14, 16], and that Campagnola duly performed all the conditions precedent and required on its part under the policies and contracts of insurance [5, 10, 14, 16] and that Campagnola also rendered to the insurance companies the proofs of loss, signed and sworn to as required by the policies [5, 10, 14, 16].

It was admitted by the original pleadings that the insurance companies failed to pay either the sums provided by the policies of insurance or under the alleged oral contracts to insure [6, 11, 14-16].

It was admitted by the pleadings that Campagnola assigned to Engleman, as assignee for the benefit of creditors generally of Campagnola all of its right to recover any proceeds or insurance payable from any loss under the policies and contracts of insurance [5, 10, 14, 16].

After the continued failure by the two insurance companies to pay any insurance, these two consolidated actions were brought to recover insurance not only on the written policies but on the oral contracts for additional insurance.

After pre-trial conferences, the two insurance companies entered into written stipulations [17-19] on April 4, 1956 to pay the face amount of the two written policies of insurance with interest from and after December 6, 1954 and on April 4, 1956 such stipulated sums were paid by the two insurance companies to the appellants.

It was stipulated [17-19] that the payments were not payments or releases or impairment of appellant's claims upon the oral contracts of additional insurance, and should not be construed as an admission by appellees of the existence of the oral contracts of insurance.

The appellants' pleadings were amended and supplemented on May 25, 1956 to eliminate any further recovery of the face amounts of the written policies which had been paid under the stipulation of April 4, 1956, and to recover only the additional insurance under the oral contracts of insurance, namely \$15,000.00 from General Accident [24-28] and \$14,000.00 from North American [20-24].

It was stipulated that answers to the original amended complaints be deemed, in effect, answers to the second

amended complaint [32-33]; the cases were consolidated [64].

The consolidated cases were tried before a jury, and at the conclusion of plaintiff's case in chief, the trial judge, after deeming the defendants' motions as motions to dismiss, granted the motions [37, 208-211] under Rule 41(b) [209-210].

From the judgment of dismissal [38-39], this appeal was taken [40], and the undertaking was filed on appeal [41-42].

Summary of Argument.

The learned and courteous district judge was in error in his view that there was not sufficient evidence to warrant a jury finding that there was an oral contract with the two defendant insurance companies for additional insurance in excess of that provided in the written policies issued by them, and in overlooking the customs and usage in the insurance business as well as the other evidence.

Fire insurance is a practical matter, and the courts have repeatedly recognized this in holdings designed to assure businessmen that the fire insurance which ordinary dealings in business lead them to believe exists, does in fact exist.

Oral contracts of insurance as well as to insure are a common practice and are valid and binding, although they are made informally.

The common practice of calling an insurance agent, or one with apparent authority, on the telephone and entering into such a contract is established and sustained by the courts in California.

The informal oral contract of fire insurance does not require a detailed discussion between the person desiring insurance and the insurer, or his agent; the courts will imply into the agreement "the terms and conditions in customary use" (*Couch, 1 Cyclopedia of Insurance Law*, 125). Where a policy is already in effect between the parties, an oral contract for *additional* insurance has been held subject to the same terms and conditions as the original policy.

California, by statute, has a standard form of fire insurance policy (California Insurance Code, sec. 2071). The parties are presumed by the courts to have contracted with reference to the standard form; the courts have implied into the agreement the terms and conditions of the standard form as well as the usual and customary terms of the type of insurance involved.

These rules are especially applicable in the instant case, where there is specific evidence of the definite customs and usages of the insurance business on every phase of these contracts.

The courts in implying these terms and conditions into a contract of insurance have frequently referred to the implications as presumptions of fact.

These are practical decisions; the average man expects to be bound on ordinary and usual terms of an insurance contract and to pay the usual and ordinary premium; he also expects the company to be bound; this expectation is doubly justified where the insured already has an insurance policy and merely wants to increase his coverage; it would be useless in such a situation to require the insured to have a detailed discussion of terms, rates, etc., with the insurance company or its agent, since

those matters are already understood between the parties; the courts have, therefore, been quick to give effect to the obvious intention of the parties, and have held, repeatedly, that under such circumstances, a clear and definite contract exists.

If it is the custom in the area that an insurance company is obligated unless it promptly declines a risk, the insurance company is bound to the contract unless it promptly notifies the agent that it will not assume the risk.

Additionally, the dual agency of insurance agents is accepted by the courts as common practice; Love represented Campagnola in placing the insurance, and represented the insurance companies in ordering and accepting it for the insurers; Love knew full well all of the terms of the oral insurance contract because of his experience in the insurance business; under ordinary agency rules, his knowledge is the knowledge of his principal; there was no uncertainty as a matter of actual fact in the contract which was made; all of the terms were understood by both parties.

Under appellant's first argument, the usual and ordinary terms of a contract are implied into the agreement and a binding contract exists, and under appellant's second argument, the agents actual knowledge of those ordinary and usual terms creates a binding contract. Under either theory, a definite oral contract for additional fire insurance existed, and the judgment should be reversed.

ARGUMENT.

I.

The Evidence, in a Review of a Dismissal Under Rule 41(b), Must Be Viewed Most Favorably to the Plaintiff.

The motion for dismissal at the close of plaintiff's case "provides for the equivalent of a nonsuit . . ." Notes of Advisory Committee on Rules, Rule 41(b).

In reviewing the evidence, in a jury case, after a dismissal under Rule 41(b), F. R. C. P., for failure to show a right to relief, as under the older motion for nonsuit, "[t]he testimony and all reasonable inferences therefrom must be viewed in the light most favorable to the plaintiff." 2 Barron & Holtzoff, *Federal Practice and Procedure*, 641 (1950); *Boal v. Electric Storage Battery Co.*, 98 F. 2d 815, 817 (3rd Cir. 1938); cf. *E. K. Wood Lumber Co. v. Moore Mill & Lumber Co.*, 97 F. 2d 402 (9th Cir. 1938); *Mateas v. Fred Harvey*, 146 F. 2d 989, 999 (9th Cir. 1945).

As has been often pointed out, the right to jury trial is involved.

Jacob v. New York City, 315 U. S. 752, 62 S. Ct. 854, 86 L. Ed. 1166 (1942).

II.

Insurance Contracts May Be Oral and May Be Made Informally.

This principle is well-established, and was also accepted by the district court judge [208].

Kazanteno v. Cal-Western, 137 Cal. App. 2d 361, 369-370, 290 P. 2d 332 (1955);

Guipre v. Kurt Hitke & Co., 109 Cal. App. 2d 7, 240 P. 2d 312 (1952);

Snyder v. Redding, 131 Cal. App. 2d 416, 280 P. 2d 811 (1955);

Gold v. Sun Insurance Co., 73 Cal. 216, 218, 14 Pac. 786-787 (1887);

29 Am. Jur. 145;

44 C. J., Sec. 951.

In *Kazanteno v. Cal-Western etc. Ins. Co.*, 137 Cal. App. 2d 361, 369-370, 290 P. 2d 332, 338 (1955), the court said:

“First, as to the sufficiency of the evidence of the making of the oral agreement. Both sides assert that California recognizes as valid oral agreements for insurance. (*Toth v. Metropolitan Life Ins. Co.*, 123 Cal. App. 185, 188, 11 P. 2d 94.) And it appears that the rule is equally applicable to all phases of insurance contracts. ‘Insurance contracts may be made by parol. A parol contract of insurance, or agreement to issue, renew, or make an indorsement upon a policy, or to waive a provision or condition thereof, is valid and enforceable. . . .’” (Citing cases.)

Extreme informality in entering into oral insurance contracts has been recognized and permitted by the courts.

In *Guipre v. Kurt Hitke & Co.*, 109 Cal. App. 2d 7, 15, 240 P. 2d 313, 317 (1952), the court said:

“As pointed out by respondent, in modern practice most of the business of the agency insurance company is conducted over the telephone. New insurance in various forms, as well as increased coverage on existing insurance is commonly ordered by telephone”

Accord: *Snyder v. Redding*, 131 Cal. App. 2d 416, 280 P. 2d 811 (1955).

III.

Where There Is a Custom Which Requires an Insurer to Promptly Decline a Risk, or Else Be Bound Thereby, a Contract of Insurance Is Formed if the Insurer Fails to Act Promptly in Refusing the Risk and the Insurer Is Liable if a Loss Occurs.

The evidence is clear. At the time that Love sent the companies his memoranda there was a definite custom in the Los Angeles area as to the effect of failure by an insurance company to decline a fire risk “at once.” In the absence of immediate declination, it was assumed by all parties that the company had agreed to assume the risk and write the insurance. Such is the evidence and the reasonable inferences therefrom [156].

As pointed out above, Love mailed the memoranda from downtown Los Angeles to the defendants (who were also located in downtown Los Angeles) prior to 10:00 A. M. on August 2, 1954 [151]. The fire occurred during the night of August 7, 1954. In the interim Love had received “no communication whatsoever” from either defendant insurance company [156].

Love relied on this custom; he heard nothing from the two defendants for five days. By custom, this silence

meant acceptance, so Love did not attempt to have the additional insurance written elsewhere [189-190].

The existence of the custom and its acceptance by the defendant insurance companies and by plaintiff's assignor is further buttressed by the fact that the companies customarily dated the enforcement of a policy from the date of the agent's memorandum, regardless of when they actually wrote the policy. And the insurance companies customarily received their premium from the date of the agent's memorandum [160-162]. See *Ransom v. Penn. Mutual Life Ins. Co.*, 43 Cal. 2d 420, 428, 274 P. 2d 633 (1954).

It is well established law that if custom requires an insurer to decline a risk solicited by its agent, and communicated to it, or else be bound, the failure to promptly decline creates a binding insurance contract.

"So, it has been said that where there is a general usage or custom to the effect that persons authorized to solicit insurance can bind their principals until it has rejected the risk and so notified the agent, who, in turn notifies the applicant, such a parol contract is valid and binding."

2 Couch, *Cyclopedia of Insurance Law* 1583;

Brown v. Franklin Mutual Fire Ins. Co., 165 Mass. 565, 43 N. E. 512;

Hallauer v. Fire Assn. of Philadelphia, 83 W. Va. 401, 98 S. E. 441;

Cf. Grange Mutual Fire Ins. Co. v. Commons, Inc., 146 F. 2d 788 (1st Cir. 1945);

Muntz v. Travelers Mutual Casualty Co., 229 Ia. 1015, 295 N. W. 837;

Bituminous Casualty Corp. v. Baldwin, 196 Va. 1020, 86 S. E. 2d 836.

In *Guipre v. Kurt Hitke & Co.*, 109 Cal. App. 2d 7, 14, 240 P. 2d 312, 316-317 (1952), the court, in holding the insurance company bound, stated:

“Under section 335, subdivision (b) of the Insurance Code, each party to a contract of insurance is bound to know ‘All the general usages of trade.’ When there is a known usage of trade, persons carrying on that trade are deemed to have contracted in reference to the usage, unless the contrary appears; and the usage forms a part of the contract. . . .”

IV.

A Definite and Certain Contract of Fire Insurance Was Entered Into Between Plaintiff's Assignor and Defendant Insurance Companies; the Usual and Ordinary Terms of a Fire Insurance Contract Will Be Implied Into the Agreement and Will Be Presumed to Be Part of the Agreement.

The learned district court judge dismissed plaintiff's case because, in his opinion, there was no meeting of the minds on the terms and conditions of the contract for insurance coverage.

In the instant case, policies of fire insurance between plaintiff's assignor, Campagnola, and the two defendants were already in existence. Love had previously discussed increased fire insurance with Esposito, Campagnola's president. Then on Friday, July 30, 1954, Esposito specifically told Love, “Dick, go ahead and place that *other* \$50,000.00 of fire insurance which we discussed some time ago” [149].

Love testified that in accord with the custom in the insurance business that the premium for the additional

insurance would be at the same rate as the original policy [149-150], that the duration of the increased insurance ran to the expiration of the original policy term [159-160] and would commence as of the date shown upon the order or as of the date specifically requested [160-161], that the premium would commence the same way [161-162]; Love testified that on July 30, 1954, he knew Campagnola wanted the additional insurance on its equipment [163].

Love sent out the usual and customary memoranda to the defendants and to another insurance carrier which is not involved in litigation, prior to 10:00 a.m. the next business day—Monday, August 2, 1954.

Love testified that the custom and practice in the insurance business was that when an insurance company has a request for any type of coverage that they do not desire or positively will not issue, that they *at once* notify with a telephone call, followed by a written letter of declination [156].

In view of the custom and practice, and the two insurance companies not having informed Love or Klee of any declination of the risk, Love relied thereon, considered the additional insurance effective with the defendants, and did not try to place it elsewhere [189-191].

In *Maryland Casualty Co. v. Industrial Accident Commission*, 179 Cal. 716, 721, 178 Pac. 858, 860 (1919), the Court held:

“The utmost that can be said of the verbal agreement . . . is that it was an agreement to insure or to issue insurance upon the usual terms contained in the company’s policies. As was said concerning an agreement to insure by the supreme court of the

United States, in *Eames v. Home Ins. Co.*, 94 U. S. 621, 629 [24 L. Ed. 298, see, also Rose's U. S. Notes]: 'It will be presumed that they contemplate such form of policy, containing such conditions and limitations as are usual in such cases, or have been used before between the parties. This is the sense and reason of the thing, and any contrary requirement should be expressly notified to the party to be effected by it.'

California has a standard form of fire insurance policy prescribed by statute—(California Insurance Code, sec. 2071). It is the law of California that the 'both parties must be *presumed* to have entered into the [oral] contract of insurance with reference to the statutory form.' *Harlow v. American Equitable Assurance Co.*, 87 Cal. App. 28, 31; 261 P. 499, 500 (1927); *Kavanaugh v. Franklin Fire Ins. Co.*, 185 Cal. 307, 315; 197 P. 99, 102 (1921).

"A parol contract of, or for, insurance, in the absence of special agreement, calls for the contract as expressed in policies commonly issued by the company on similar risks, and is to be regarded as made upon the terms, and subject to the conditions, in the ordinary forms of policies. In fact, where the terms are not expressly agreed upon, it will be *presumed* that the parties contemplated such terms, conditions, and limitations as are usual in policies issued to cover like risks, *or in policies previously used by the parties. And an oral contract for additional insurance is subject to the same terms and conditions as the original policy.*" (Emphasis added.)

1 Couch, *Cyclopedia of Insurance Law*, 138-139.

"In the absence of proof to the contrary, it will be *presumed* . . . that an oral contract to in-

sure was an agreement to insure in the terms of the policy then in use by insurer; that insured and insurer knew the terms of the policy; that insurer knew the meaning which a valid local usage had attached to a term in the policy, and knew the location and nature of the business insured and the substances used therein."

46 *Corpus Juris Secundum*, 412-413.

"In some instances, however, it is not essential to an oral contract of insurance that every detail should be expressly agreed upon, since an implied agreement concerning essentials is as good as an express agreement. It will also be observed that the difficulty in establishing an oral contract is frequently obviated, in part, at least, by the *presumption* that the parties contemplated the provisions and conditions of the usual written policy. More particularly, it is generally held that in cases of oral insurance contracts for original insurance, where no terms are expressly agreed upon, it is presumed that the parties contemplated those contained in policies usually issued to cover like risks."

29 Am. Jur. 147.

In 15 A. L. R. 1008-1009, it is said:

"It is generally held that, in cases of oral insurance contracts for original insurance, where no terms are expressly agreed upon, it is presumed that the parties contemplated those contained in policies usually issued to cover like risks." (1008) 69 A. L. R. 568; 92 A. L. R. 238, 239.

In *Pacific Fire Ins. Co. v. Donald*, 148 Tex. 277, 282, 224 S. W. 2d 204, 207 (1949), the court said:

“There is nothing in the record to indicate that Donald expected any other kind of policy than the usual standard form of policy in use by the insurer at the time. In view of this testimony, the rule stated in the note annotating the cases in connection with the opinion of the Supreme Court of Washington in the case of *Chenier et al. v. Insurance Company of North America*, 72 Wash. 27, 129 P. 905, 48 L. R. A., N. S. 319, Ann. Cas. 1914D, 649, is applicable. On page 653 of Ann. Cas. 1914D, the rule is stated as follows: ‘It is well settled that an oral agreement to insure against fire is presumed to be made in contemplation of a policy containing the terms and conditions in customary use, and impliedly to adopt the same, and it is on this ground that such agreements are sustained as complete and binding contracts. . . .’”

Preferred Risk Fire Ins. Co. v. Neet, 262 Ky. 257, 262-263, 90 S. W. 2d 39, 40 (1935);

Appleman, 12 *Insurance Law and Practice*, 275.

In *Green v. Liverpool & London & Globe Ins. Co.*, 91 Ia. 615, 60 N. W. 189 (1894), the court held that an oral agreement increasing the amount of insurance on previously insured property was valid and binding. The presumed and implied intention of the parties was that all of the old terms should apply to the new contract, except as specifically changed. There was no uncertainty. The minds of the parties had met.

Milwaukee Bedding Co. v. Graefner, 182 Wisc. 171, 180, 196 N. W. 533, 536-537 (1923);

Michigan Pipe Co. v. North British & Mercantile Ins. Co., 97 Mich. 493, 56 N. W. 849 (1893).

The usual, ordinary and customary terms of a fire insurance contract, including the premium, the effective date, the duration and all other usual and ordinary terms will be implied into the oral understanding. They will be *presumed* to have existed.

Each of the usual, ordinary and customary terms of a contract for increased fire insurance coverage was specifically proved in this case [159-164; see Statement of Facts]. There was nothing left to conjecture or to surmise, the court and the jury had presented to them a specific meeting of the minds and a contract under which certain parties agreed. The holding of the court below is contrary to the overwhelming weight of authority, both within and without California. The ruling below would require a business man who already has a fire insurance policy to go through a ritualistic incantation of terms, which are already completely understood, disregarding custom and usage, every time he wanted increased coverage. Such a useless requirement is not imposed by the law. We submit that the district court judge erred in imposing such a requirement. The judgment of dismissal should be reversed.

V.

Regardless of Any Implication or Presumptions of Fact as to What Was Intended by the Parties, Richard Love Acted as Agent for Both the Insured and the Defendants and Had Actual Knowledge of All the Terms and Conditions of the Insurance Contract. His Knowledge Is Imputable to the Insurance Company in Order to Show a Meeting of the Minds.

This point states an alternative ground for reversal.

A fire insurance agent customarily acts in a dual capacity. He acts as agent for the company and he acts as agent for the person wishing insurance. This was proved as a fact in this case [181, 191-192; see Statement of Facts].

“The Witness (Mr. Love): Well, Mr. Miller, according to the Insurance Code an agent is appointed by the company and represents the company. But, in fact, if he did nothing but represent the company he probably wouldn’t sell much insurance. He contracts these accounts, builds up his accounts through good will, and over a long period of time, and, by and large, the public who deals with an insurance agent considers he is their agent.

“That is what I meant by dual capacity. They consider you represent them. Whereas, in effect, you technically do not.”

This is the normal operating procedure of a fire insurance agent, and has been repeatedly so recognized by the courts.

In *New Zealand Ins. Co. v. Larsen Lumber Co.*, 13 F. 2d 374, 375 (7th Cir. 1926), the court said:

“The question, therefore, remains one of agency—the authority of B. to bind both the insured and the insurer by agreement, and to terminate immediately, existing insurance. A fire insurance agent’s authority to act in certain fields for the insured as well as the insurer is so well settled that authorities seem superfluous.”

In *Home Ins. Co. v. Campbell*, 79 F. 2d 588, 590 (4th Cir. 1935), the court said:

“It will be noted that in the transactions relating to the insurance both before and after the fire, Mauney was acting in the dual capacity of policy writing agent for The Home Insurance Company and also as agent for the insured. This is very customary in fire insurance practice and is legally unobjectionable where the agent acts in entire good faith and with due authority from both principals.
. . . .”

In *American Eagle Fire Ins. Co. v. Burdine*, 200 F. 26, 30 (10th Cir. 1952), the court said:

“To be sure, the agent could have acted both for the insurer and the insured. He could have acted for the insured in the preparation of the reports and for the insurer in the reception of them—as indeed he did. There is no legal barrier to this dual role on the part of the agent. He may serve both the insured and insurer so long as his duties are not inconsistent.”

See also

Iowa National Mutual Ins. Co. v. Richards, 229 F. 2d 210 (7th Cir. 1956);

Hawkeye Clay Works v. Globe & Rutgers Fire Ins. Co., 202 Ia. 1270, 1274, 211 N. W. 860, 863 (1927);

29 Am. Jur. 115-116;

Cf. Maloney v. Rhode Island Ins. Co., 115 Cal. App. 2d 238, 244-245, 251 P. 2d 1027, 1030-1031 (1953).

Under ordinary agency principles, therefore, the actual knowledge of Love as to all the customs and usages and the intent of both parties bound both parties.

Hawkeye Clay Works v. Globe & Rutgers Fire Ins. Co., 202 Ia. 1270, 1274, 211 N. W. 860, 863 (1927).

There was no uncertainty in Love's mind as to what the contract was; he testified with absolute clarity as to the customs, practices and usages with reference to which the contracts were made [156-164]; moreover, the parties are presumed to know the general usages of the insurance trade. (California Ins. Code 335(b).)

Guipre v. Kurt Hitke & Co., 109 Cal. App. 2d 7, 240 P. 2d 312 (1952).

Thus, even without implying usual and ordinary terms into the contract, or presuming their existence, it is clear both parties knew (if they did not otherwise know) by means of Love's dual agency, each and every term of the insurance contract. The trial court judge erred in dismissing for failure of the plaintiff to prove a meeting of the minds.

Conclusion.

It is abundantly clear what Esposito meant when he said to Love: "Dick go ahead and place that other \$50,000 of fire insurance which we discussed some time ago" [149]; he meant that he was accepting the prior proposals of Love for an increase in his coverage, and to be bound on the same terms as his existing contracts, to pay premiums at the same rate as before, to have the enforcement start as of the date of the memoranda sent by Love, as had been done before, and to cover the same equipment as before until his present insurance contracts expired.

The trial court's opinion and basis of dismissal was contrary to the established authority that the law will imply such ordinary, usual and customary terms into the oral contract—in order to effectuate the intentions of the parties.

The theory of dual agency (Point V) is well-supported factually and legally. It supplies an alternative ground for reversal.

The very least that can be said is that the judge below erred in taking the questions of the factual inferences from the jury.

The judgment of dismissal should be reversed.

Respectfully submitted,

HARRY J. MILLER,

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Attorneys for Appellant.

No. 15315.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

M. W. ENGLEMAN, as Assignee for the Benefit of Creditors Generally of Campagnola Food Products, Inc., a Corporation,

Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a Corporation,

Appellees.

APPELLEES' BRIEF.

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GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a Corporation,

Appellees.

APPELLEES' BRIEF.

Statement of the Case.

These cases, consolidated for trial before a jury, were tried upon the issues made by plaintiffs' second amended and supplemental complaints against the two defendants, appellees herein [Tr. pp. 20-28], and defendants' separate answers thereto. [Tr. pp. 32-33, 14-17.]

After stipulations and admissions, there were no substantial issues raised except those raised by Paragraphs IV of the separate second amended and supplemental com-

plaints and defendants' denials thereof. These allegations were as follows:

IV.

Thereafter and prior to the night of August 7, 1954, the Insurance Company entered into an additional and oral agreement with Campagnola under which the Insurance Company additionally insured Campagnola against loss by fire of equipment of Campagnola, for a sum of \$15,000.00, besides the foregoing sum of \$12,000.00 specified in the said policy; that the said agreement was separate from the policy; that the period for such additional insurance commenced from August 2, 1954, and was to expire on May 10, 1955; the property insured against was equipment of Campagnola; the risk insured against was fire; there was to be a premium and consideration for such additional agreement of insurance, in accordance with customary rates. [Tr. p. 21, f. 21; p. 25, f. 25; p. 14, f. 11; p. 16, f. 14; p. 32, f. 31, 32.]

The case came on for trial on June 19, 1956, and the plaintiff introduced his evidence and on June 20, 1956, rested his cause.

Defendants, and each of them, thereupon made the following motion:

1. Plaintiff having rested, defendants and each of them separately moves the court to direct the jury to return its verdict in favor of defendants and each of them upon the ground and for the reason that plaintiff's evidence has failed to establish facts or inferences therefrom upon which a verdict of the jury could be based in plaintiff's favor against defendants or either of them, specifically in that there is no evidence that defendants or either of them entered into an oral contract of insurance with the plaintiff's assignor.

2. There is no evidence that anyone authorized by defendants or either of them entered into an oral contract of insurance with plaintiff's assignor.

3. There is no evidence or inference therefrom that defendants or either of them are estopped to deny that the oral contract was entered into by them or either of them.

4. There is no evidence that witness Charles Richard Love had any authority to enter into an oral contract of insurance on behalf of defendants or either of them. [209.]

5. There is no evidence that Charles Richard Love did enter into any oral contract with plaintiff's assignor on behalf of defendants or either of them. [Tr. pp. 193-194, ff. 208, 209.]

After argument, the Court, treating the motion for directed verdict as a motion to dismiss, ordered a dismissal of the actions without prejudice. [Tr. p. 209, f. 226; p. 37.] Thereafter, the Court entered formal judgment of dismissal without prejudice. [Tr. pp. 38, 39.]

Statement of Facts.

The issues on this appeal are simple and resolve into the single question,

“Did Appellant produce sufficient testimony and evidence, resolving the same and all reasonable in-tendments therefrom in his favor, to establish that his assignor had entered into contracts of insurance with each of the Appellees as alleged?”

The evidence, which consisted of the testimony of two witnesses, Kenneth H. Klee and Charles Richard Love, and the documents introduced during their testimony, shows the following:

Kenneth H. Klee testified that he was at all times in the suit material an insurance agent and broker in Los Angeles, California, and had conducted his business under the name of The Klee Insurance Agency for about six and a half years. He was the duly appointed and acting agent of appellee, General Accident and Life Assurance Corporation, Limited, under a written agency agreement [Pltf. Ex. 1, Tr. p. 85, f. 101], and also the duly appointed and acting agent for appellee, Insurance Company of North America, under a similar written agency appointment. [Pltf. Ex. 2, Tr. p. 90, f. 101; p. 96, f. 104.]

Since 1950, Klee and witness, Charles Richard Love, had shared offices, occupying desks across from each other; they shared telephone, stenographic, and other expenses. Although each individually transacted business for their own accounts, they would, as a matter of courtesy, when one was sick or on a vacation, watch the business of the other and help each other although they did not pay each other commissions unless they worked on a case jointly. Generally speaking, they maintained their own entities, and although they shared office expenses, they each operated independently. [Tr. p. 96, f. 105; 116, f. 122.] During all the time that Klee and Love shared offices together, they each had brokers licenses, and each placed business with the other in companies which the other represented. [Tr. p. 141, f. 151.] Klee had never had any discussion with appellee, General Accident [Tr. pp. 97, 98, f. 106], nor with the appellee, Insurance Company of North America, other than about his, Klee's, appointment as agent. [Tr. p. 100, f. 109.]

In reference to appellee, General Accident, Love had an agency appointment with this appellee, and after his

agency was cancelled, he placed or renewed some of his business through The Klee Agency. [Tr. p. 103, f. 112.]

He had no relationship with the Campagnola Food Products, Inc. insurance, other than when Love first got the line and had to place it. Love represented the General Accident, and the fire facilities were quite limited, and Love asked him where he could place the balance, and he suggested to him that he call the Insurance Company of North America and see if they would take the insurance, and he later learned that the Insurance Company of North America did take this insurance and placed it through his, Klee's, agency. [Tr. p. 104, f. 113.]

With reference to the transaction in controversy, he knew or heard nothing about it until after the fire on Sunday when he noticed in the paper that Campagnola had suffered a fire loss, and he called Love to see if he had read it, and Love told him that he did not know about it, and that he had ordered some additional insurance on the line the previous week. [Tr. p. 106, f. 116; p. 109, f. 119.]

Charles Richard Love testified that he was an insurance agent and had been in the insurance business approximately eight years and had started as agent in his own capacity about July of 1950, occupying an office with witness Klee and testified substantially the same as witness Klee as to the arrangements between them in the matter of sharing expenses and facilities. [Tr. p. 141, p. 142, ff. 152, 153.]

That he had been appointed agent for appellee, General Accident Fire and Life Assurance Corporation, by written appointment in September, 1950, and that his

appointment had been revoked on November, 1952, and the notice of revocation filed with the Insurance Commissioner, and he received notice of the revocation on November 21, 1952. [Tr. p. 143, ff. 153, 154; p. 167, f. 179; p. 169, f. 181.]

That he had been handling the insurance for Campagnola Food Products, Inc., Appellants' assignor, since 1951, and was handling a major portion of it. That Mr. Esposito was the only man he dealt with in Campagnola with the exception of the bookkeeper occasionally. [Tr. p. 174, f. 186; p. 178, f. 191.]

That on May 16, 1952, as agent for General Accident Fire and Life Assurance Corp., he executed and delivered to Campagnola a policy of insurance. When this policy expired on May 16, 1953, after the cancellation of his agency appointment, the business was transacted in Mr. Klee's name [Tr. p. 147, f. 158; p. 179, f. 193], and after his agency was cancelled, he could not write the policy in the General Accident so he placed the insurance that was expiring in the General Accident through Mr. Klee as agent for the General Accident. [Tr. p. 180, f. 194.] He explained that he meant by "placing" that he would offer a piece of business to a company and have them accept it and issue a policy; that is, he would submit the proposal to the company for their acceptance or rejection, and in many instances he submitted business to Mr. Klee or submitted it directly with Mr. Klee's authorization, and such business was submitted to companies for their acceptance or rejection. [Tr. p. 171, f. 184; p. 172, f. 184; p. 172, ff. 184, 185.]

As to Appellee, Insurance Company of North America, he transacted the Campagnola policy issued in 1952 through Mr. Klee on this basis. [Tr. p. 148, f. 159.]

He was not, and never had been, agent for the Insurance Company of North America, and had been agent for the General Accident only during the period from September, 1950, to November, 1952, when his agency was cancelled. That after the cancellation of his agency, he never held himself out to Appellant's assignor or to anyone else as having authority to bind the General Accident. [Tr. p. 171, f. 183.]

In August of 1954, there were two fire insurance policies in effect so far as is material in this issue, one with the Appellee, General Accident, for \$11,000.00, which had been placed by Love through the Klee Agency effective May 16, 1953 [Tr. p. 21, f. 21], and the other with Appellee, Insurance Company of North America, for \$12,000.00 effective May 10, 1952, which had been placed by Mr. Love through the Klee Agency. [Tr. p. 25, f. 25.]

Prior to July 30, 1954, Mr. Love had lunch with Mr. Esposito, representing Appellants' assignor, and was told that some financial rearrangements were in process, and that the fire insurance would probably have to be increased, as there would be loans involved, and the lenders would want additional protection. Mr. Esposito did not state who the lenders would be but advised Mr. Love that he would let him know if the increase was to be made. [Tr. p. 176, f. 189.]

On July 30th, Mr. Love called the bookkeeper at Appellants' assignor's place of business on another matter, and after he had finished his conversation, Mr. Esposito came on the telephone and, in substance, told him to "go ahead and place that other \$50,000.00 of fire insurance which we discussed some time ago." [Tr. p. 149, f. 160.] Esposito told Love that the deal they had dis-

cussed had gone through, and he wanted the additional insurance they had discussed, and Love stated to him that he would immediately make application to insurance companies to see if he could place the business. [Tr. p. 174, f. 187.] Love did not tell Esposita what companies he was going to make application to and did not tell him when the contract, if any were made, would go into effect. He did not tell him how the \$50,000.00 was to be divided between any companies if he could place it, and he did not discuss with him for how long the insurance would endure, the terms or the end of it, and did not discuss with him the rate. He did not discuss with him the parties to the contract, that is, the loss payees who were to be placed on the policies. [Tr. p. 174, f. 187; p. 175, f. 188.] This telephone conversation of July 30, 1954, was the last and only conversation Mr. Love had with Mr. Esposita until after the fire. [Tr. p. 184, p. 199.]

Mr. Love did not immediately make any effort or attempt to place this insurance but on April 2, 1954, sent by regular mail to the General Accident a letter as follows:

“Love Insurance Agency
510 W. Sixth Street
Los Angeles 14, California

To: Gen. Acc.

Subject: Campagnola #784651.

Attention:

Date: 8-3-54

Will you increase your line by endorsement to \$25,000 part of total line of \$88,000. Advise immediately.

DICK LOVE”

and to the Insurance Company of North America a letter as follows:

“Love Insurance Agency
510 W. Sixth Street
Los Angeles 14, California

To: Ins. Co. North Am.
Subject: Campagnola #61296
Attention: Fire Und.
Date: 8-3-54

Will you endorse to increase your line to \$27,000, part of total line of \$88,000. Advise immediately.

K. H. KLEE”

[Pltf. Exs. 4, 5, p. 152, p. 153, f. 164.]

Mr. Love received no answers to these communications until after the fire, although he received several telephone calls from Insurance Company of North America, which were abortive for the reason that he was not in when the calls were made and the person who had called him was not in when he returned the calls. [Tr. p. 185, p. 186, ff. 199, 200.]

The fire occurred on August 7th and the amount of loss and the performance of conditions precedent was stipulated to.

ARGUMENT.

It would seem that a recitation of the facts adduced at the trial would be its own argument, as these cases must be, and were by the trial court, determined on the most elementary principles of contract law.

When stripped of extraneous matters, all of the material testimony can be briefly summarized.

Kenneth H. Klee and Charles Richard Love were each insurance agents and brokers, sharing offices and office expenses, but were not partners and maintained their own entities and operated independently. Klee at all times herein was the duly appointed and acting agent for each of the Appellee insurance companies, but had nothing to do with the transaction herein involved and knew nothing about it until after the property had been destroyed by the fire of August 7, 1954.

Love at the time of the transactions herein involved was not the agent for either of the Appellees, although he had been agent for General Accident from September, 1950, to November, 1952, when his agency was cancelled, and after the cancellation he had never held himself out to Appellants' assignor or to anyone else as representing or having authority to bind the General Accident.

Love had a client or customer, Appellants' assignor Campagnola Food Products, Inc. with whom he was transacting considerable business. In May of 1952, he procured fire insurance for Campagnola, one policy for \$12,000.00 with Insurance Company of North America, which he negotiated with said insurance company through Mr. Klee as its agent. The other policy for \$11,000.00 with General Accident he himself issued as agent for the General Accident. When this General Accident policy

expired in May of 1953, after his agency with said company had been revoked, he caused it to be renewed through Mr. Klee, as agent for said company.

Prior to July 30, 1954, Love had a conversation with Mr. Esposito, Campagnola's President and Manager, wherein he was advised that Campagnola was making some financial arrangements and that the lenders would want additional insurance protection, and on July 30, 1954, in a telephone conversation, Esposito told Love that this deal had gone through and he wanted the additional insurance they had discussed and to place \$50,000.00 additional insurance, and Love stated to him that he would immediately make application to insurance companies to see if he would place the insurance.

Thereafter, and on August 2, 1954, Love sent to the two Appellees the letters of inquiry. [Pltf. Exs. 4, 5.] No other transactions whatsoever were had regarding the matter until after the fire.

This is the whole story and where Appellant can find evidence in the record or a theory of law to torture it into an insurance contract with either of the Appellees certainly does not appear in either Appellant's brief or in his statements of points. The facts here are so simple that it would seem trite and presumptuous to cite authority for the simple rules of contract involving offer and acceptance, privity and mutuality or the other simple elements of all contracts.

But see:

Cal. Civ. Code, Secs. 1550, 1565.

And insurance contracts are governed by the same general rules which pertain to all contracts. As said in the

case of *Gandelman v. Mercantile Insurance Co.*, 90 Fed. Supp. 472 (affirmed by this court 187 F. 2d 654):

“Insurance policies are governed by the same general rules which pertain to all contracts and the alleged contracts of insurance must meet the same test that would apply to any contract. *K. C. Working Chemical Co. v. Eureka Security Fire & Marine Ins. Co.*, *supra*; 14 Cal. Juris. 416. Tested by the ordinary rules of contract there must have been a meeting of the minds, supported by an offer and acceptance. *K. C. Working Chemical Co. v. Eureka Security Fire & Marine Ins. Co.*, *supra*. In the case at bar there never was an offer or acceptance or meeting of the minds of the parties. . . .”

In *Stevenson v. Sun Insurance Office*, 17 Cal. App. 280, 119 Pac. 529, the Court said:

“A contract of insurance must be governed and interpreted by the same rules which ordinarily apply to other contracts, and it will be enforced only according to the manifest intention of the parties.”

In *Boyer v. United States Fidelity & Guaranty Co.*, 206 Cal. 273, 247 Pac. 57, the Court said:

“Insurance policies are governed by the same general rules which pertain to all contracts. There must be a meeting of the minds.”

See also:

Mauck v. Northwestern Nat'l Ins. Co., 102 Cal. App. 510, 283 Pac. 338;

Wells Fargo & Co. v. Pacific Insurance Co., 44 Cal. 398;

Bassi v. Springfield Fire Ins. Co., 57 Cal. App. 707, 208 Pac. 154;

Boole v. Union Marine Ins. Co., 52 Cal. App. 207, 198 Pac. 416.

Since, as we believe, the answer to this appeal is found in such elementary rules of law, we will not at this point attempt to justify them but will examine Appellants' brief to see whether or not he has demonstrated that cardinal principles no longer exist and will present our points and authorities in the order as set up in Appellants' argument.

I.

Appellees' Answer to Appellant's Point I.

Appellant first argues that the evidence must be viewed most favorably to the Plaintiff. This we admit and no citation of authority is necessary.

II.

Appellees' Answer to Appellant's Point II.

Appellant next argues that insurance contracts may be oral. This is true, and the necessary elements upon which the minds of the parties must meet to constitute an oral contract of insurance have been thoroughly settled in the Courts of California and in this Circuit.

In *American Can Co. v. Agricultural Ins. Co.*, 12 Cal. App. 133, 106 Pac. 720, the Court said:

"A parol contract of insurance may be made and is enforceable; but as such contracts are rarely made, and are not made in the usual and ordinary course of business, the proof of such oral contract must be clear and convincing. In fact, it is the universal custom of insurance companies to issue written policies, with full and minute specifications as to their liability and the exceptions that would make the policy void. The preliminaries, as in contracts for the sale of real estate, are usually only negotiations which are afterward merged into the written contract.

Hence it is at once apparent, even to the layman, that in the somewhat unusual claim that an oral contract of insurance was entered into, the only safe and sound rule is to require the proof to be clear and convincing to the effect that the contract was actually entered into, that each party understood it in the same light, and in regard to the same subject matter. (*Kerr on Insurance*, 52, sec. 33; 13 *Am. & Eng. Ency. of Law*, p. 221; *Cleveland Oil & Paint Mfg. Co. vs. Norwich Union Fire Ins. Co.*, 34 Or. 228, (55 Pac. 435).)"

The Court further said in this case:

"A contract is an agreement to do or not to do a particular thing. It must be by consent, which is free, mutual and communicated by each to the other. The consent is not mutual unless the parties all agree upon the same thing in the same sense, and unless they do so agree there is no contract. How can it be said that the defendant agreed to issue a policy to plaintiff when the name of plaintiff was not even mentioned nor in any way communicated to defendant in the oral conversation?"

See also:

Gandelman v. Mercantile Ins. Co., *supra*;

Law v. Northern Assurance Co., 165 Cal. 394,
132 Pac. 500;

Toth v. Metropolitan Life Insurance Co., 123 Cal.
App. 185, 11 P. 2d 94.

We are quoting from *K. C. Working Chemical Co. v. Eureka Security Fire and Marine Insurance Co.*, 82 Cal. App. 2d 120, 185 P. 2d 832, to avoid the numerous citations of authorities that might be given as in this case

Judge Vallée epitomized the rules relating to oral contracts of insurance and cited numerous authorities. In that case, the Court said:

“To constitute a verbal contract of insurance the minds of the parties must have met upon all of the essential elements of the contract. The testimony must make clear the subject-matter of insurance, the amount and elements of the risk, including its duration in point of time and extent in point of hazard assumed, the rate of premium, and generally all the circumstances which are peculiar to the contract and distinguish it from every other so that nothing remains to be done but to fill up the policy and deliver it, on the one hand, and pay the premium on the other. (Citing cases.) * * *

“Oral contracts of insurance must be definite and certain. The parties must agree on all of the essential terms. (Citing cases.) * * *

“To constitute a valid contract of insurance the minds of the parties must have met on the identity of the person with whom they are dealing. (Citing cases.) * * *

“A contract of insurance is not effected by a transaction which does not supply the element of mutuality of agreement and mutuality of obligation. (Citing cases.) * * *

“Until an application for insurance is accepted, no contractual relation exists between an applicant for insurance and an insurance company. (Citing cases.) * * *

“An insurance company is not bound to accept an application or proposal for insurance but may reject it for any reason or arbitrarily. (Citing cases.) * * *

“A mere intention or mental determination on the part of the insurer to accept the application is not of itself sufficient to effect a binding contract. (Citing cases.) * * *

“A contract of insurance must be assented to by both parties either in person or by their agents. (Citing cases.) * * *

“There can be no enforceable contract of insurance if the insured and an agent who represents several companies fail to designate one of the companies before a loss occurs. (Citing cases.) * * *

“It is held in a number of cases that payment of the premium is a condition which must be fulfilled if temporary insurance is to be considered as affording protection to the applicant. (Citing cases.) * * *

“Mere delay in acting on an application does not create a contract of insurance. (Citing cases.)”

Examining the evidence in light of the law where, how and when was any oral contract of insurance entered into between Appellants' assignor and either of the Appellees by which they became mutually bound.

Clearly, no contract was consummated or assumed to be consummated in the brief telephone conversation which Love had with Assignor's manager, Esposita, on July 30, 1954. The most that can be gotten out of this was that Esposita told Love to place \$50,000.00 insurance and Love told him he would make application to insurance companies and see if he could place the business. Love did not tell him the names of the companies he was going to make application to or how the \$50,000.00 was to be divided between companies. (As said in the *Gandelman* case, *supra*, this itself was fatal to a contract.)

He did not tell him when the contracts if they were made would go into effect. He did not discuss with him how long the insurance would endure. He did not discuss with him the rate. He did not discuss with him the parties payee. In other words, all that passed between Love and Esposita was Esposita's desire to get \$50,000.00 additional insurance and Love's agreement to attempt to get it for him.

Moreover, Love could not have entered into a contract with Esposita on behalf of either of the Appellees if he had tried. He was not the agent of either of the Appellees, and although he had been agent for General Accident for a short time, his agency had been cancelled, and after its cancellation, he did not act or assume to act as agent for said company and did not and had not held himself out either to Appellants' assignor or anyone else as having authority to bind the General Accident.

If oral contracts of insurance did not arise, as they clearly did not, with this transaction, when did they arise?

The only other act or conduct relating to the matter was the sending by Love of the two letters dated April 3, 1954, to the respective Appellees [Pltf. Exs. 4, 5 above quoted], to which no answers were received until after the fire on August 7, 1954. An examination of these exhibits will show that they are not even proposals to the Appellees but, on the contrary, are mere inquiries. One says "Will you increase your line by endorsement . . ." and the other says: "Will you endorse to increase your line . . ." Suppose each of the Appellees had answered "Yes." There still would have been no contract. Love would have had to come back and accept

it. However, nothing was done, and as shown by the authorities above cited, an insurance company is not bound to accept an application or proposal for insurance, and a delay in acting on an application does not create a contract, if we can assume the three or four days interval was a delay.

Aside from the two instances just referred to, there is absolutely nothing in the evidence relating to a meeting of the minds with anybody or for any specific contract or contracts.

III.

Appellees' Answer to Appellant's Point III.

Appellant's next argument which is under this sub-head is the statement that where there is a custom which requires an insurer to promptly decline a risk or else be bound thereby a contract of insurance is formed if he fails to act promptly in refusing the risk.

Cases cited on pages 16 and 17 of Plaintiff's brief and even the quotations therein do not even remotely bear out the statement made out in this sub-head, and we do not propose to burden this brief by a detailed analysis of these cases, but will state categorically that an examination of the cases show that they are all cases where an agent with actual or ostensible authority had actually entered into a completed contract with the applicant subject to his company's rejection, and the Courts, of course, held that the risk under those conditions was bound until rejected by the company.

But in this case, there was certainly no binding of any company by the transaction with Esposita, or the sending of the letters.

IV.

Appellees' Answer to Appellant's Point IV.

Under this sub-head, Appellant makes the categorical statement that a definite and certain contract of fire insurance was entered into between Appellants' assignor and Defendant insurance companies. We have already answered this contention under sub-head II, and will say nothing more about it.

He also under this sub-head states that the usual and ordinary terms of a fire insurance contract will be implied into the agreement.

We can agree with this; that is, as the cases which counsel has cited amply show in a fire insurance contract it will be presumed that the standard form of policy will be used, and if the contract for renewal is entered into, that the new oral contract would follow the terms of the previous policy. But this is speaking of the detailed terms and form of the contract and not of the essential elements such as the amounts, the divisions, between companies and the other elements that relate to the particular transaction as above discussed. Obviously, the form of the contract is immaterial until there has been a meeting of the minds.

V.

Appellees' Answer to Appellant's Point V.

The last struggling effort of Appellant to make a case is under his sub-head V in which he makes the remarkable statement that Love acted as agent for all parties and had knowledge of the terms and conditions of the insurance contract and, therefore, his knowledge is imputable to the insurance company in order to show a meeting of the minds.

Appellant cites several cases on pages 25 and 26 of his brief to attempt to justify this remarkable theory, but an examination of these cases will show that in each and every one of them where a party was permitted to act as agent for both parties with the full knowledge and consent of both, and where the transactions were not inconsistent or incompatible with his duties to either.

But here Love was not even an agent for either of the Appellees and he knew he was not their agent, and he did not act, or assume to act, as their agent and had never done so or held himself out as authorized to do so after the cancellation of his General Accident agency. We wonder if Appellant is claiming that Love could have estopped himself as against himself and thereby create a contract in his own mind.

Appellant has discussed custom. Aside from the facts that Love testified that he did not know that certain customs of the business that he testified to were recognized

by either of the Appellees, it is too well settled for controversy that although custom and usage may be shown as an instrument of interpretation it can never be used to create a contract.

Cal. Code Civ. Proc., Sec. 1870 (12);

Hanley v. Marsh and McLennan, 48 Cal. App. 2d 787, at 798, 117 P. 2d 69;

Ghiselin v. John Hancock Mutual Life Ins. Co., 79 Cal. App. 2d 438, 180 P. 2d 50.

Appellees respectfully submit that the trial court did not err in taking the case from the jury and dismissing the action and that there is not a scintilla of evidence in the whole case upon which a verdict against Appellees could have been sustained.

Respectfully submitted,

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By E. EUGENE DAVIS,

Attorneys for Appellees.

No. 15315

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

M. W. ENGLEMAN, as Assignee for the Benefit of Creditors Generally of Campagnola Food Products, Inc., a Corporation,

Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a Corporation,

Appellees.

APPELLANT'S REPLY BRIEF.

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Appellees.

APPELLANT'S REPLY BRIEF.

Preliminary Statement.

The weakness of appellees' position is illustrated by claims that citation of authority for their contentions would be "trite and presumptuous" (*e. g.* Appellees' Br. p. 11), by admittedly substituting categorical statements for "detailed analysis" (*id.* p. 18) and by failure to cite any authority whatever on the critical issues of this case.

Furthermore, accusing appellant of "torturing" the evidence (Appellees' Br. p. 11), characterizing our argument as an attempt to demonstrate "that cardinal principles no longer exist" (*id.* p. 13), describing an argument based on the authority of decisions by United States Courts of Appeal as a "last struggling effort" (*id.* p. 20) are statements which practically amount to a confession of inability to answer, when placed in a brief which is devoid of authority or logical analysis on the critical issues. Such

statements by appellees do not take the place of authority or reason.

Appellees' "factual" statement demonstrates further weakness; they concede, as they must, that all evidentiary conflicts and inferences must be resolved in appellant's favor (Appellees' Br. pp. 3, 13). Yet, they review the evidence in the light most favorable to themselves and have completely omitted, except for a passing reference, any mention of the significant evidence of custom and usage in the insurance business in the Los Angeles area.

This evidence is of tremendous importance in the case from at least two standpoints: (1) The manner of acceptance of offers for additional insurance was thereby proved. Despite defendant's protestations, the very principles of general contract law which they so solemnly invoke (Appellees' Br. pp. 11-13) are clear on this point; by custom and usage an offeree may make silence his badge of acceptance; in this case the custom was definitely and thoroughly proved. (2) The second significance of custom in this case lies in legislation. By statute in California "[e]ach party to an insurance contract is bound to know . . . [a]ll the general usage of trade" (California Insurance Code 335(b).) The cases hold that this applies equally to the usages of the insurance business.

Appellees have not squarely faced the proved facts of the case; they have preferred to treat appellant's arguments with disdain, rather than to even attempt an answer. Appellees have not, by "categorical" statement (See Appellees' Br. p. 18) or otherwise, distinguished plaintiff's cases; furthermore, they have cited no applicable authority supporting their position on the critical issues involved.

We must assume that appellees' counsel have stated their position as forcefully as it can be stated. Yet their answer amounts to no answer at all.

Appellant is entitled to a reversal of the judgment of dismissal, and is entitled to have the jury consider his case

ARGUMENT.

Introductory.

Plaintiff-Appellant has made three fundamental arguments:

(1) That “the testimony and all reasonable inferences therefrom must be viewed in the light most favorable to the plaintiff” (Appellant’s Op. Br., Pt. I, p. 14); appellees admit that this rule is correct (Appellees’ Br. p. 13), although they fail to honor it.

(2) That plaintiff’s assignor and defendants entered into a binding preliminary oral contract for increased insurance by means of offer on the part of Campagnola and acceptance by defendants; this argument is made by appellant in three steps (Points II, III and IV of our opening brief):

(a) Binding insurance contracts may be made orally and informally (Appellant’s Op. Br., Pt. II, pp. 15-16); appellees admit that this is correct (“This is true . . .” Appellees’ Br. p. 13).

(b) An offer to enter into an insurance contract is accepted by silence if custom requires prompt notice of declination in order to avoid being bound (Appellant’s Op. Br., Pt. III, pp. 16-18); appellees cite no authority in opposition; instead they make a “categorical” statement (Appellees’ Br. pp. 16-18).

(c) The parties to an insurance contract need not discuss or even mention the usual and ordinary terms of an insurance contract, such as premium, duration, date of commencement, etc. These matters have been and will be implied by the courts into the parties’ understanding (Appellant’s Op. Br., Pt. IV, pp. 18-23). Although Appellees protest (pp. 8, 16-17, of their brief) that lack of express discussion of these items is fatal, *yet they concede (on p. 19 of their brief) that appellant’s position is correct.* They

raise a new point: No contract arose because of the failure of Love, the agent, to tell Esposito, Campagnola's president, the name of companies and the amount of insurance, of the \$50,000 total, which had been assigned to each. This argument is contrary to a solid body of authority both within and without California.

(3) Appellant claims that Love acted as a dual agent, and his acts and knowledge bound both plaintiff's assignor and the companies. Although this argument has a solid factual basis in the record of this case and a solid legal basis in the decided cases, appellees apparently prefer to spoof it, rather than to answer.

We shall deal with each of appellees' arguments within the framework of our arguments for reversal.

We shall not state as a separate point in this brief the elementary rule that on an appeal such as this, plaintiff is entitled to have the evidence and all inferences therefrom viewed most favorably to him. The point is conceded, although not honored, by appellees.

I.

A Binding Oral Preliminary Insurance Contract for Increased Coverage Was Entered Into Directly Between Defendants and Plaintiff's Assignor.

A. Preliminary Contracts for Increased Insurance Coverage May Be Made Orally and Informally.

Several of the cases standing for this well-established proposition are cited at pages 15-16 of our opening brief. For example, the role of the telephone has received express judicial recognition in California. *Guipre v. Kurt Hitke & Co.*, 109 Cal. App. 2d 7, 15, 240 P. 2d 312, 317 (1952), holding enforceable an oral contract of original insurance which was formed by telephone conversations.

Appellees concede the point: "This is true . . ." (Appellees Br. p. 13).

1. However, appellees argue that such contracts are rare and unusual (pp. 13-14). Appellees seem to imply that the courts should look with a jaundiced eye upon such agreements. Appellees cite such cases as *American Can Co. v. Agricultural Ins. Co.*, 12 Cal. App. 133, 106 Pac. 720, decided in 1909, and *Law v. Northern Assurance Co.*, 165 Cal. 394, 132 Pac. 590, decided in 1913, by a department of the California Supreme Court under the former practice in this state.

The very short answer to the "rare and unusual" argument is that it is no longer true factually or sound legally. As a legal proposition, the very cases and the very language relied upon here by appellees have been disapproved.

In a recent California decision, *Parlier Fruit Co. v. Fireman's Fund Ins. Co.*, 151 A. C. A. 6, 24, 311 P. 2d 62, 74 (1957, reh. den. Hearing by California Supreme Ct. den.) the appellate court expressly disapproves the "rare" and "unusual" rule and expressly disapproves the *American Can* and *Law* cases, which the appellees in this case have cited in their Brief. The Court states unequivocally:

"While it may have been true that in 1909 and 1913, parol contracts of insurance were rarely made, such statement is no longer true."

Also in *Guipre v. Kurt Hitke & Co.*, 109 Cal. App. 2d 7, 15, 240 P. 2d 312, 317 (1952), the court said:

"As pointed out by respondent, in modern practice most of the business of the agency insurance company is conducted over the telephone. New insurance in various forms, *as well as increased coverage on existing insurance is commonly ordered by telephone.*
. . ."

Accord: *Kasanteno v. Cal. Western etc. Ins. Co.*, 137 Cal. App. 2d 361, 290 P. 2d 332 (1955).

2. Appellees also argue (pp. 11-12) that an insurance contract is a contract which is governed by the rules of law applicable to contracts.

Since we are, in this case, seeking enforcement of contract rights, we agree with appellees that an insurance contract is a contract. If, however, appellees are seeking to imply that there is no body of law which has developed specifically governing insurance contracts, we disagree. Without mentioning the specific insurance texts such as those written by Couch and Appleman, American Jurisprudence devotes 150 pages *exclusively to an examination of the particular rules applicable to insurance contracts* (29 Am. Jur. 141-289), *Corpus Juris* devotes 350 pages (44 C. J. S. 927-1302) to the same subject, and California Jurisprudence devotes 235 pages (27 Cal. Jur. 2d 650-824 to 28 Cal. Jur. 2d 11-72). There is a specific body of law relative to insurance contracts and it governs this case; it calls for reversal and submission of the case to the jury.

3. In their brief appellees set forth a lengthy quotation from Judge Vallée's opinion in *K. C. Working Chemical Co. v. Eureka Security Fire & Marine Ins. Co.*, 82 Cal. App. 2d 120, 185 P. 2d 832 (1947), and seem to imply that that case imposes some sort of barrier to plaintiff's recovery here. The short reply is that the holding of the *Working* case was favorable to the insured, and the case involved a completely different issue—authority of an agent to cancel existing insurance. Moreover, there is nothing in Judge Vallée's statement which is in any way contrary to plaintiff's position here. Every statement made by Judge Vallée is met by the proof in this case and the rules of law applicable thereto.

B. The Contract Was Definite and Certain.

Appellee made quite an argument in the court below that there was no contract because the minds of the parties had not met on the various terms of an insurance contract [*e. g.* R. 194-195].

Despite the fact that all the terms were customary and this case involved simply an *increase* in coverage under already existing policies, the trial court accepted the argument and made it the *sole* basis of the judgment of dismissal [*e. g.* R. 198, 204].

We set forth (at pp. 13-18 Op. Br.) the rule relative to ordinary and usual terms of an insurance contract: the courts have repeatedly implied into the understanding between the parties each and every item asserted by defendants here as a fatal deficiency.

Defendants now repeat this argument (pp. 8, 16-17 of their brief) and urge that the contract was fatally defective because Love, the agent, did not tell Esposito (the president of plaintiff's assignor) "when the contract . . . would go into effect" (pp. 8, 17), "how long the insurance would endure" (pp. 8, 17), "the terms or end of it" (*id.* p. 8), "the rate" (pp. 8, 17), or "the loss payees" (*id.* pp. 8, 17); on page 19 of their brief they admit, however, that our argument is correct.

1. As pointed out in our opening brief (pp. 18-23), each of these matters is the subject of customary and usual terms and the parties will be *presumed* to have contracted with reference to these customary and usual terms.

Couch, 1 *Cyclopedia of Insurance Law*, 124-125, 138-139; 46 C. J. S. 412-413; 29 Am. Jur. 147; 15 A. L. R. 1008-1009; 69 A. L. R. 568; 92 A. L. R. 238, 239; *Maryland Casualty Co. v. Industrial Acc. Commission*, 179 Cal. 716, 721, 178 Pac. 858, 860 (1919).

In *Guipre v. Kurt Hitke & Co.*, 109 Cal. App. 7, 14, 240 P. 2d 312 (1952), the court, in holding the insurance company bound, held:

"Under section 335, subdivision (b) of the Insurance Code, each party to a contract of insurance is bound to know 'All the general usages of trade.' When

there is a known usage of trade, persons carrying on that trade are deemed to have contracted in reference to the usage, unless the contrary appears; and the usage forms a part of the contract. Evidence of usage is always admissible to supply a *deficiency* or as a means of interpretation where it does not alter or vary the terms of the contract. (*Watson Land Co. v. Rio Grande Oil Co.*, 61 Cal. App. 2d 269, 272 [142 P. 2d 940].)” (Emphasis supplied.)

Such is the situation here.

Accord:

Kazanteno v. California-Western etc. Ins. Co., 137 Cal. App. 2d 361, 290 P. 2d 332 (1955);

Stanley v. Columbia Casualty Co., 63 Cal. App. 2d 724, 147 Pac. 682 (1944);

Chase v. National Indemnity Co., 129 Cal. App. 2d 853, 278 P. 2d 68 (1954) (Parole waiver of term of contract; held binding on insurer).

Cases from other jurisdictions, as well as the United States Supreme Court, are in accord.

Eames v. Home Ins. Co., 94 U. S. 621, 627, 629 (1877):

“But it is objected, in the next place, that the contract, if one was made, was not complete and precise in its terms; that it did not state the period of time during which the risk was to continue, and did not state what kind of a policy (of two or three different kinds which the Home Company used) Eames wished to have. It does appear that the application, which was signed on the 13th of October, did not (as is usually done) call for a statement of the period of insurance. It was one of the Company’s own printed blanks, and the probability is, that the reason this

item was not inserted was the almost universal practice of taking ordinary insurance against fire for a year. Nothing else seems to have been in the minds of the parties. The former insurance on the property has been for that period. . . . We think it perfectly manifest, from all the evidence taken together, that the parties meant and intended an insurance for a year, and had nothing else in their minds. This is the inference to be drawn from all their conduct, conversations, and correspondence; and we should be sticking in the bark to ignore it.

“The plea, that no time for the continuance of the insurance was stipulated for, is evidently a mere after-thought.

“There is no difficulty as to the time when the risk was to commence. It was the practice of the defendant, as it is of most, if not all, other companies, to ante-date the policy to the time of making the application; which, in this case, was on the 12th day of October, 1872. . . .

“As to the plea that the contract does not specify what kind of a policy was desired, it does not appear that the complainants had any knowledge or notice that the defendant issued different kinds of policies. As Eames justly said, he supposed (as he had a right to suppose) that they would get the same kind of policy which had been issued on the property before. *If no preliminary contract would be valid unless it specified minutely the terms to be contained in the policy to be issued, no such contract could ever be made or would ever be of any use.* The very reason for sustaining such contracts is, that the parties may have the benefit of them during that incipient period when the papers are being perfected and transmitted. *It is sufficient if one party proposes to be insured, and the other party agrees to insure, and the subject, the*

period, the amount and the rate of insurance is ascertained or understood, and the premium paid if demanded. It will be presumed that they contemplate such form of policy, containing such conditions and limitations as are usual in such cases, or have been used before between the parties. This is the sense and reason of the thing, and any contrary requirement should be expressly notified to the party to be affected by it." (Emphasis supplied.)

The Massachusetts Supreme Judicial Court has even gone to the extreme of holding "An oral agreement for insurance is not rendered invalid because more information must be had before a policy can be written." *Shumway v. Home Fire & Marine Ins. Co. of California*, 301 Mass. 391, 395, 17 N. E. 2d 212, 214 (1938). In the instant case, of course, the defendants had been insuring plaintiff's assignor against fire prior to the increase in the insured amount. These defendants needed no more facts.

See also:

15 A. L. R. 1008-1009; 69 A. L. R. 568; 92 A. L. R. 238, 239; *Milwaukee Bedding Co. v. Graebner*, 182 Wisc. 171, 180, 196 N. W. 533, 536-537 (1923); *Michigan Pipe Co. v. North British & Mercantile Ins. Co.*, 97 Mich. 493, 56 N. W. 849 (1893); *Preferred Risk Fire Ins. Co. v. Neet*, 262 Ky. 257, 90 S. W. 2d 39 (1936); *Rommel v. New Brunswick Fire Ins. Co.*, 214 Minn. 251, 8 N. W. 2d 28 (1943); *Elliot v. Standard Accident Ins. Co.*, 92 N. H. 505, 33 A. 2d 562 (1943); *Auston v. New Brunswick Fire Ins. Co.*, 111 Mont. 329, 108 P. 2d 1036 (1941); *Chenier v. Insurance Company of North America*, 72 Wash. 27, 129 Pac. 905, 48 L. R. A. (N. S.) 319 (1913) (renewal).

In Pacific Fire Ins. Co. v. Donald, 148 Tex. 277, 282, 224 S. W. 2d 204, 207 (1949), the court held:

“There is nothing in the record to indicate that Donald expected any other kind of policy than the usual standard form of policy in use by the insurer at the time. In view of this testimony, the rule stated in the note annotating the cases in connection with the opinion of the Supreme Court of Washington in the case of *Chenier, et al. v. Insurance Company of North America*, 72 Wash. 27, 129 P. 905, 48 L. R. A., N. S. 319, Ann. Cas. 1914D, 649, is applicable. On page 653 of Ann. Cas. 1914D, the rule is stated as follows: ‘It is well settled that an oral agreement to insure against fire is presumed to be made in contemplation of a policy containing the terms and conditions in customary use, and impliedly to adopt the same, and it is on this ground that such agreements are sustained as complete and binding contracts.’ In support of this rule a long list of decisions and authorities is cited. See also *Connecticut Fire Ins. Co. et al. v. Fields*, Tex. Civ. App., 236 S. W. 790, and *Dalton v. Norwich Union Fire Ins. Soc.*, Tex. Com. App., 213 S. W. 230. And the risk will be regarded as beginning with the completion of the contract, which in this instance was when Moore agreed to insure the hay. *Schubert v. McLain & McLain*, Tex. Civ. App., 27 S. W. 2d 846; *Western National Ins. Co. v. LeClare*, 9 Cir., 163 F. 2d 337; *Potter, et al. v. Phenix Ins. Co.*, C. C., 63 F. 382.”

2. As to renewal or modification of a contract already existing between the parties, the problem, as recognized by the Supreme Court in the *Eames* case, is even more easily solved because all of the terms have already been definitely spelled out between the parties. The parties are already well aware of the terms. Thus, the courts have had even less difficulty in binding the insurer under such circumstance.

See, *e. g.*:

Green v. Liverpool & London & Globe Ins. Co.,
91 Ia. 615, 60 N. W. 189 (1894);

Milwaukee Bedding Co. v. Graebner, 182 Wisc.
171, 180, 196 N. W. 533, 536-537 (1923);

*Michigan Pipe Co. v. North British & Mercantile
Ins. Co.*, 97 Mich. 493, 56 N. W. 849 (1893).

3. The matter of the amount of premium is discussed in the cases cited above. However, because it was of particular interest to the trial judge, and is now stressed by appellees, we point out that the testimony is uncontradicted that all insurance companies charge the same rate [R. 149-150]. This fact is well understood. It has been judicially noticed by several courts.

See, *e. g.*, *Preferred Risk Fire Ins. Co. v. Neet*, 262 Ky. 257, 262-263, 90 S. W. 2d 39, 40 (1935), in which the court said:

“As to the premium: Since fire insurance rates in any particular community and on specific property are known to be uniform and standard, *the law implies a promise to pay whatever premium is so chargeable.*”
(Emphasis supplied.)

In Appleman, 12 *Insurance Law and Practice* 275, it is said:

“Where an oral agreement to insure is entered into, without specifying the premium rate, it is a contract to insure at the customary rates.”

The law is clear. The usual, ordinary and customary terms of a fire insurance contract, including the premium, the effective date, the duration and all other usual and ordinary terms will be implied into the oral understanding. They will be *presumed* to have existed.

4. In addition to this impressive collection of authorities, there is a very recent California case in which one

of the present appellees, Insurance Company of North America, was also a party, which holds squarely in accord with appellant's contentions: *Parlier Fruit Co. v. Fireman's Fund Ins. Co., et al.*, 151 A. C. A. 6, 18-25, 311 P. 2d 62, 69-76 (1957).

In that case one Rebholtz was general agent for all seven of the defendant insurance companies (one of which is an appellee in the instant case), just as Klee was the general agent for both defendants in this case; Babish, who was not a general agent, worked for Rebholtz and handled all of the insured's business, much as Love did for Campagnola in this case. About two months before a fire on the insured's premises, Babish spoke to the insured's president about use and occupancy fire insurance. Nine days before the fire Babish told the president that he didn't know which form of such insurance would be best for plaintiff. Five types of coverage were written by the companies. At that time Babish and the president agreed upon \$100,000, later reduced to \$75,000. That was the sole element discussed, just as here only the amount of \$50,000 increased insurance was specifically stated. After one insurance company declined to write the full amount, Babish wrote the six other companies requesting the coverage, dividing the amounts between them, without telling plaintiff or its agents how the amounts were being split up. *The court in the Parlier case held the companies bound to the coverage.*

Although the companies wrote five different types of use and occupancy insurance, the court implied into the agreement the understanding that the companies knew they were binding plaintiff for the kind of insurance best suited to plaintiff's needs (151 A. C. A. 6, 20-21). The period of the preliminary insurance was also implied (*id.* pp. 21-22). The percentage of coverage was not specifically agreed upon. The court implied that it would be a reasonable percentage (*id.* p. 21).

No premium rate was discussed. The court held:

"Rate. The premium rate would necessarily be the company's rate for the coverage received. There is implied an agreement to pay the usual premium (44 C. J. S. 959)."

Thus, California is squarely in accord with the general authorities. Furthermore, it should be pointed out that despite the appellees' protestations (pp. 8, 16-17 of appellees' brief) as to the deficiencies, appellees (on p. 19) apparently concede, as they must, that our argument is correct ("We can agree with this . . .").

5. Appellees also contend that plaintiff's case must fail because Love did not tell Esposito what companies would be used or what amounts of the \$50,000 total would be allocated to them (Appellees' Br. pp. 8, 16-17, 19).

This argument is opposed by overwhelming authority. *Plaintiff's position has been accepted in the very recent California decision which specifically rejects appellees' contention.* In the *Parlier* case, *supra*, 151 A. C. A. 6, 311 P. 2d 62 (1957), the plaintiff president simply told Babish that he wanted \$75,000 worth of use and occupancy insurance. There was no discussion as to names of companies nor was the discussion of division of the total amount between them. Babish designated the companies and the amounts prior to the fire just as Love did here. *The court held the companies bound in the amounts designated:*

"Here, plaintiff expressly agreed to accept a total insurance amount up to \$75,000 *and impliedly agreed to accept from each company the amount allocated to it by Babish* (the agent's employer), provided only that the total from all companies did not exceed \$75,000. Each defendant agreed to coverage in a particular sum. All the elements required to make a binding contract were present." (*Id.* p. 22.)

The court specifically approved and quoted from (*id.* p. 23) the holding in *Lumbermen's Mut. Ins. Co. v. Slide Rule & Scale Engineering Co.*, 177 F. 2d 305, 309-310 (7th Cir. 1949), where the court held:

"It is said that the parties' minds did not meet upon the names of the companies to be bound. We think this wholly immaterial under the facts and circumstances of record. When the agent represents several companies and selects certain of them to be bound by the risk, he is contracting for undisclosed principles. Each of the companies he represents has intrusted him with the agency, and must be held to have given authority as such agent to select it as the one to bear the risk. Such authority springs inevitably from his authority to make insurance contracts. The insured cannot be permitted to suffer because the agent fails to disclose at the time of making the contract which of several principals he binds. *Aetna Insurance Company of Hartford, Conn. v. Licking Valley Milling Co.*, 6 Cir., 19 F. 2d 177; *Elliott v. Standard Accident Insurance Company*, 92 N. H. 505, 33 A. 2d 562; *Milwaukee Bedding Co. v. Graebner*, 182 Wisc. 171, 196 N. W. 533; *Federal Insurance Co. of Hartford, Conn. v. Sydeman*, 82 N. H. 482, 136 A. 136; *Fire Insurance Company of Philadelphia County v. Sinsabaugh*, 101 Ill. App. 55."

In *Milwaukee Bedding Co. v. Graebner*, 182 Wisc. 171, 181, 196 N. W. 533, 536, 537 (1923), the court said:

"In such case the agent becomes the agent of the insured for the purpose of selecting the company."

Rommel v. New Brunswick Fire Ins. Co., 214 Minn. 251, 263-264, 8 N. W. 2d 28, 35 (1943);

Elliott v. Standard Accident Ins. Co., 92 N. H. 505, 511-512, 33 A. 2d 562, 567 (1943);

12 Appleman, *Insurance Law & Practice* 286.

In California, in the Federal Courts, and throughout the United States, the rule is well established.

Moreover, in the instant case it was clearly proved that Love did in fact, prior to the fire of August 7, 1954, designate the companies to take the \$50,000 increase. He prepared the memoranda on August 1, 1954. He mailed the memoranda to each of the defendants on August 2, 1954 [R. 151-153]. The companies received the memoranda [R. 151]. He allocated the additional insurance in a very definite manner: \$14,000 was allocated to General Accident [R. 153]. \$15,000 was allocated to North American [R. 158]. \$21,000 was allocated to a third company and is not the subject of litigation [R. 158].

Under the authorities, Love's designation of the insurers was binding upon the companies.

Furthermore, under the proved facts, it was clear that plaintiff's assignor *already* had fire insurance with the defendants. It is a reasonable inference that when Esposito requested additional insurance [R. 149], he intended that the same companies be used. (See, *Western Nat. Ins. Co. v. LeClare*, 163 F. 2d 337, 340 (9th Cir. 1947).)

Appellees' argument, which cites no authority, is incorrect. The insurers having been designated prior to the loss, the contract was binding.

C. The Contract Was Accepted by Defendants. They Failed to Promptly Decline the Risk in the Face of a Custom Which Required Them to Do so if They Did Not Wish to Be Bound.

The evidence and the law on this point are both clear. Love testified that when a request for coverage is made, if a company wishes to decline, it must do so "at once." The uncontradicted evidence is that silence in *the face of this custom indicates acceptance of the requested coverage* [R. 155-156]. Love testified that if a company did

not wish to be bound “they *at once* notify you with a telephone call, followed by a written letter of declination” [R. 156].

Love’s conversation with Esposito took place on Friday, July 30, 1954. Esposito told Love, “Dick, go ahead and place that other \$50,000 of fire insurance which we discussed some time ago” [R. 149]. On the next working day, Monday, August 2, 1954, Love mailed the memoranda to the companies.¹ The fire occurred in the evening of the *following Saturday*, August 7, 1954. No communication was received from either defendant between Monday, August 2, 1954 and the time of the fire.

The legal propositions on which plaintiff relies are well established.

1. As a matter of insurance law, if custom requires an insurer to decline a risk solicited by its agent or sub-agent and communicated to it, failure to promptly² decline creates a binding insurance contract.

“So, it has been said that where there is a general usage or custom to the effect that persons authorized to solicit insurance can bind their principals until it has rejected the risk and so notified the agent, who, in turn notifies the applicant, such a parol contract is valid and binding.”

2 Couch, *Cyclopedia of Insurance Law* 1583; *Brown v. Franklin Mutual Fire Ins. Co.*, 165 Mass. 565,

¹There is no evidence as to the time of day on Friday, July 30, 1954 when the conversation took place. The evidence as to the time of mailing of the memoranda is in the record: they were mailed prior to 10:00 A. M. the following Monday. Appellees’ statement that “Mr. Love did not immediately make any effort to place this insurance. . . .” (Appellees’ Br. p. 8) is but a demonstration of appellees continual resolution of factual inferences in their own favor.

²The custom applicable in this case required coverage to be declined “at once” [R. 156].

43 N. E. 512; *Hallauer v. Fire Assn. of Philadelphia*, 83 W. Va. 401, 98 S. E. 441; *Cf. Grange Mutual Fire Ins. Co. v. Commons, Inc.*, 146 F. 2d 788 (1st Cir. 1945); *Muntz v. Travelers Mutual Casualty Co.*, 229 Ia. 1015, 295 N. W. 837; *Bituminous Casualty Corp. v. Baldwin*, 196 Va. 1020, 86 S. E. 2d 836.

Appellees refuse to make a "detailed analysis of these cases" (Appellees' Br. p. 18). Rather, they "state categorically" that they apply only to cases where an agent has actual or ostensible authority and enters into a "completed contract" (*id.* p. 8).

Our reply may be briefly made. The proof here is of authority to bind the appellees by means of subagency of Love, acquiesced and concurred in by these insurance companies for a considerable period of time [See our Statement of Facts, Op. Br. pp. 5-6; R. 101-104, 135-138]. *The trial judge specifically held that plaintiff had made out his case on the subagency issue* [R. 197-198, 204, 208]. It is, of course, hornbook law that a subagent may bind the principal just as the agent may.

1 *Restatement of the Law of Agency*, Sec. 142(b), p. 367, states:

"As far as the contractual relations between the principal and third persons are concerned, a subagent has the same power as an agent."

California Civil Code, Sec. 2351:

"A subagent . . . represents the principal in like manner with the original agent."

Accord:

2 Cal. Jur. 2d 722.

The general rules of agency law apply to insurance companies and their agents.

Frasch v. Londen & Lancashire Fire Ins. Co., 213 Cal. 219, 223, 2 P. 2d 147 (1931);

Snyder v. Redding Motors, 131 Cal. App. 2d 416, 421, 280 P. 2d 811 (1955).

As to the second part of their "categorical statement," we submit that appellees are incorrect and that the cases cited support our position, not theirs. There would be no need for the rule if it applied only to "completed" contracts; the contract would be binding at that point and the rule would never have come into existence.

2. Aside from these special rules in insurance cases, the general principles of contract law, so solemnly invoked by appellees, are quite clear on this point.

An offeree may, by custom and usage, make silence his badge of acceptance. *Here the evidence and the reasonable inferences therefrom is that, in August of 1954, in the Los Angeles area, if an insurer did not wish to be bound on the terms of its agent's memorandum, it declined at once by telephone and then wrote a letter of declination.* Love received no communications either oral or written prior to the fire.

The general contract principle is stated by Williston thusly:

"The offeree may authorize the offeror to regard silence as an acceptance of his offer. Such authorization is not likely to be given in express terms, but the conduct of the offeree in previous dealings . . . may have justified the offeror in understanding silence as assent. If he does so understand there is a contract. . . .

"Evidence of usage in a particular trade has been held admissible with other circumstances to prove assent a justifiable inference from silence.

“A further extension of this doctrine is developing in the cases,—that, *where an offeree solicits the offer* [as occurred in this case], this, in the light of the relations of the parties or other surrounding circumstances, may justify the offeror as a reasonable man in interpreting the offeree’s silence after receiving the offer as acceptance.”

1 Williston on Contracts, 286-288.

In *Truscon Steel Co. v. Cooke*, 98 F. 2d 905, 911 (10th Cir. 1938), quoting from *Laredo Nat. Bank v. Gordon*, 61 F. 2d 906, 907 (5th Cir. 1932), the court held:

“[W]here the relation between the parties is such that the offeror is justified in expecting a reply, or the offeree is under a duty to reply, the latter’s silence will be regarded as acceptance. Under such circumstances, ‘one who keeps silent, knowing that his silence will be misinterpreted, should not be allowed to deny the natural interpretation of his conduct,’ etc.”

In 12 Cal. Jur. 2d 214, it is said:

“Whenever the relation between the parties is such that the offeror is justified in expecting a reply, or the offeree is under a duty to reply, the latter’s silence will be regarded as acceptance.”

3. The evidence in this case showed that the companies customarily (in the absence of specific contrary instructions) dated enforcement of a new policy or a change in an old one from the date of the agent’s memorandum, regardless of when they actually wrote the policy. *Moreover, the companies customarily charged their premiums from the date of agents’ memorandum* [R. 160-162].

In the recent California case, *Parlier Fruit Co. v. Fireman’s Fund Ins. Co.*, 151 A. C. A. 6, 20-21, 311 P. 2d 62, 72 (1957), where similar facts were proved, the court

held that the insurer was bound and that to hold otherwise would be to sanction a fraud:

“To hold otherwise would mean that parol binders although recognized by law to be valid, are only valid if the insurance company wants to consider them so. Thus, when the permanent policy is issued and the insured charged a premium for the period covered in the binder, a fraud would be consummated, as the insured would be charged the back premium, even though he really had no protection during the period charged for.”

Defendant companies were silent here for almost a week in face of a custom that required prompt action. If there had been no fire they would have charged their premium from the date of the agent's memorandum [R. 160-162]. To permit them to deny coverage would be tantamount to permitting a fraud. Neither the California courts, nor any others, courts of which we are aware have allowed the insurer to escape liability under such facts.

Moreover, Love, as agent of plaintiff's assignor, when he received no communication from the defendants, relied on these customs and assumed the companies by their silence had indicated that they were bound. He, therefore, made no effort to place the insurance elsewhere [R. 189-191]. The companies should not be now permitted to deny the coverage.

4. At several points in their brief defendants attempt to characterize the memoranda sent by Love to the insurance companies as “mere inquiries” (Appellees' Br. *e. g.* pp. 11, 17). This is but another illustration of appellees' error in resolving all factual inferences in their own favor.

The memoranda which were sent and which were received by the defendants [R. 151] were the usual method of obtaining insurance for a client. While phrased as re-

quests, the memoranda contained no question marks. The testimony was quite clear that memoranda such as these were all that the companies customarily required as a basis for a preliminary contract of insurance and for writing the final policy or issuing a modification. The companies customarily dated their formal documents as of the date of the agent's memoranda [R. 160-162]. *They had followed this custom in dealing with plaintiff's assignor in the past* [R. 161].

Moreover, the companies customarily charged the premium from the date of the agent's order [R. 161-162]; it avails appellees nothing to call the memoranda "mere inquiries"; the companies themselves customarily regarded them as a great deal more, and plaintiff's assignor was made aware of this practice by these very defendants.

The companies were bound. They were bound (1) under rules specifically relating to insurance contracts, (2) under the ordinary rules of contract law, and (3) under their own practice. They dated their policies and modifications, charged premiums *from the date of the agent's memoranda*. The defendants should not be permitted to escape liability by characterizing as "mere inquiries" the memoranda upon which they customarily considered themselves bound. To permit the insurance companies to thus escape liability would be, in the words of the California courts, to permit consummation of a fraud (*Parlier Fruit Co. v. Fireman's Fund Ins. Co.*, 151 A. C. A. 6, 20-21, 311 P. 2d 62, 72 (1957)).

II.

Love Acted as Agent for Both the Insured and the Defendants and Had Actual Knowledge of All the Terms and Conditions of the Insurance Contract.

The trial judge rendered judgment of dismissal because plaintiff had, in his opinion, failed to spell out agreement between the parties on the various minutiae of the contract for increased insurance [R. 204, 208]. He did not base his judgment on any supposed failure of the companies to accept whatever had been offered, and he specifically stated that plaintiff had made out a jury case on the agency issue [R. 197-198, 204, 208].

It was the supposed failure of plaintiff to prove, in the judge's words "What was offered? What was accepted?" [R. 204], that resulted in this judgment.

We have heretofore cited the applicable authorities on implying into the agreement the usual and customary terms of the contract. We have pointed out that in a very recent California case the *trial* judge took exactly the same position as Judge Tolin did here. He was reversed. The appellate court ruled that it would imply the usual and customary elements into the contract. *Parlier Fruit Co. v. Fireman's Fund Ins. Co.*, 151 A. C. A. 6, 311 P. 2d 62 (1957). This line of authority alone requires reversal.

But reversal is also required on the basis of Love's dual agency. As the cases cited in the opening brief demonstrate, Love represented both the insurance companies and the insured. Love's knowledge of the usual and customary terms of the contract for increased coverage was proved. This knowledge is, on ordinary agency principles, imputed to his principal; thus no ground for asserting indefiniteness exists; Love knew exactly what the terms of the contract were.

Appellees call the argument a "last struggling effort"; they cite no cases in opposition.

It was proved that Love acted in this case as an agent in a dual capacity, and that this is customary in the fire insurance field [R. 181, 191-192].

The cases (at pp. 25-26 of our opening brief) abundantly sustain the proposition that it is customary in fire insurance for the same agent to represent both insured and insurer.

As stated in *Home Ins. Co. v. Campbell*, 79 F. 2d 588, 590 (4th Cir. 1935):

"It will be noted that in the transactions relating to the insurance both before and after the fire, Mauney was acting in the dual capacity of policy writing agent for The Home Insurance Company and also as agent for the insured. This is very customary in fire insurance practice and is legally unobjectionable where the agent acts in entire good faith and with due authority from both principals. . . ."

Appellees seek to avoid the effect of those cases and the rule which they announce by (1) calling it a "remarkable theory," (2) saying that it applies only where "a party was permitted to act as agent for both parties with the full knowledge and consent of both" and his position was not inconsistent, and (3) arguing that Love was not an agent of either appellee.

Reply may be briefly made.

1. The theory is not "remarkable." Our research discloses wide acceptance by the courts. The court's attention is directed to the cases cited in our opening brief (pp. 25-26) and the failure of appellees to cite any authority in opposition. Moreover, it was proved in this case that the dual agency was customary and that it actually existed.

2. The cases stand for the proposition that an agent's dual capacity in the fire insurance field is usual and customary. It is unobjectionable: consent is implied unless some adversity of interest is shown and none was shown in the instant case. Appellees attempted "distinction" is thus totally ineffective.

3. The argument that Love was not an agent at all overlooks all of the evidence as to the subagency and the defendants continual, knowing, acceptance of insurance obtained by Love and written through Klee's agency. That this agency was proved sufficiently for submission to the jury was explicitly held by the trial judge [R. 197-198, 204, 208].

Without restating all of the evidence which supports the trial judge's conclusion on this point, the following facts should be sufficient to refute appellees' contention that "Love was not even an agent for either of the appellees" (Appellees' Br. p. 20).

At all pertinent times Love was an "insurance agent" [R. 141]. Commencing in 1950, Love was a general agent for defendant General Accident [R. 143; Pltf. Ex. 6]. There is no evidence that plaintiff's assignor was ever notified of the termination of Love's general agency for General Accident. Love's name appears, pursuant to authority, on the original fire insurance policy issued by General Accident to Campagnola [R. 144-145; Pltf. Ex. 6].

After Love's general agency for General Accident terminated, Love continued to handle all of his existing business with General Accident through Kenneth H. Klee, who at all relevant times was a formally appointed general agent for both General Accident and North American [R. 147-148, 172, 84-93; Pltf. Exs. 1, 2].

Love also transacted business with North American through Klee [R. 136-138]. Love testified:

“A. In many instances I submit my business to Mr. Klee with—or *submit it directly under his name with his authorization.*

Q. *You mean submit it directly under his name, with his authorization, to companies that he represents?* A. *That is correct.*” (Emphasis supplied.)

Love had, as agent for General Accident, obtained for Campagnola a written policy for \$11,000 [R. 145], which he renewed through Klee [R. 180]. Acting through Klee, Love, in 1953, obtained the North American \$14,000 policy [R. 144-145, 148].

Furthermore it was shown that the procedure of Love’s handling business through Klee’s name was acquiesced in by both Klee and the two defendant insurance companies; their records reflected that Love was placing business with them through Klee [R. 101-104, 135-138].

As pointed out previously, the acts and knowledge of a subagent bind his principal in the same manner as if he were an agent.

1 *Restatement of the Law of Agency*, Sec. 142(b), p. 367;

California Civil Code, Sec. 2351;

2 Cal. Jur. 2d 722.

This dual agency, well-established in this case both legally and factually, supplies an alternative ground for reversal.

The learned and courteous trial judge based his dismissal on the failure of the minds of the parties to meet on the terms of the contract. This was, we submit, error—an error identical to that made by the trial judge in the very recent *Parlier* case, 151 A. C. A. 6, 311 P. 2d 62

(1957), and which resulted in reversal there. This court should follow the state law as announced in the *Parlier* case. Here the judgment of dismissal may be reversed by the court either on the theory widely adopted throughout the United States and recently reaffirmed by the California court in the *Parlier* case: A court will imply into the understanding of the parties the usual and ordinary terms of an insurance contract and will not permit the reasonable expectations of reasonable businessmen to be defeated by disclaimers of liability which arrive after the fire. Or the court may reverse on the theory of dual agency: the agent, representing both parties, knew all of the terms of the contract.

Conclusion.

Appellees have submitted a brief which does not meet appellant's arguments. The propositions of law and fact urged in our opening brief remain unanswered.

Appellees urged one new proposition in their brief: There was no contract because Love never told plaintiff's assignor what insurance companies were designated or what amounts assigned to them. That contention is squarely met herein. The evidence is uncontradicted that Love designated the companies and the amounts some five days prior to the fire. Under the authorities previously cited, this action by the agent obviates all objection based on non-designation.

In conclusion it should be pointed out that appellees' refusal to even state the evidence as to custom and usage shows the inherent weakness in their position. Their argument that custom and usage cannot create a contract is not applicable to this case.

Custom and usage may be and have been used to provide the unexpressed elements on which the minds of the parties have met and to prove the customary method of accepting offers. Plaintiff here seeks to have such evidence

used in this manner. As stated by a recent California insurance decision:

“Evidence of usage is always admissible *to supply a deficiency or* as a means of interpretation where it does not alter or vary the terms of the contract.”

Guipre v. Kurt Hitke & Co., 109 Cal. App. 2d 7, 14, 240 P. 2d 312 (1952).

The many cases relied upon by appellants from *Eames v. Home Ins. Co.*, 94 U. S. 621, 24 L. Ed. 298 (1877), to the *Parlier* case, 151 A. C. A. 6, 311 P. 2d 62 (1957), have relied on such evidence of custom and usage and have implied the usual and ordinary terms of an insurance contract into the agreement between the parties.

We submit that plaintiff is entitled to have his case go to the jury. The judgment should be reversed.

Respectfully submitted,

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No. 15315
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

M. W. ENGLEMAN, as Assignee for the Benefit of Creditors Generally of Campagnola Food Products, Inc., a corporation,

Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a corporation,

Appellees.

PETITION FOR REHEARING.

HARRY J. MILLER,
ROBERT HAVES,

9201 Wilshire Boulevard,
Beverly Hills, California,

Attorneys for Appellant.

FILED

FEB - 7 1958

PAUL P. O'BRIEN, CLERK

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No. 15315
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

M. W. ENGLEMAN, as Assignee for the Benefit of Creditors Generally of Campagnola Food Products, Inc., a corporation,

Appellant,

vs.

GENERAL ACCIDENT, FIRE AND LIFE ASSURANCE CORPORATION and INSURANCE COMPANY OF NORTH AMERICA, a corporation,

Appellees.

PETITION FOR REHEARING.

To the Honorable Albert Lee Stephens, Chief Judge, and to the Associate Judges of the United States Court of Appeals for the Ninth Circuit:

Appellant respectfully petitions this Honorable Court for a rehearing on the grounds hereinafter stated.

Introduction and Statement of Reasons for the Granting of a Petition for Rehearing.

This is not the *pro forma* petition of a disappointed litigant, filed simply to urge again an already rejected theory of his case. The reason for this petition is that the opinion of the Court raises, for the first time in this case, certain fundamental issues concerning the rights

of litigants in the Federal courts. These issues have not been previously briefed or argued. Involved are the Seventh Amendment to the United States Constitution, the interpretation of Federal Rules of Civil Procedure 41(b), 50(a) and 52, and the impact of the Court's opinion upon the doctrine of *Erie Railroad v. Tompkins*, 304 U. S. 64 (1938).

A rehearing is strongly urged for the following reasons:

1. The Opinion of this Court holding that the judgment below should not be reversed unless "clearly erroneous" is at variance with the established rules of appellate review of jury cases dismissed at the close of plaintiff's case and seriously prejudices appellant's rights under the Seventh Amendment.

2. Appellant has been deprived of a jury trial on a critical question of fact—had a reasonable time for reply elapsed between the making of the offer and the fire.

For these reasons, a rehearing should be granted and the judgment reversed.

ARGUMENT.

I.

Upon Appellate Review of a Judgment Based Upon Dismissal at Close of Plaintiff's Case, in a Jury Trial, the Test Is Not Whether the Trial Judge's Ruling Was "Clearly Erroneous". Rather, Plaintiff Is Entitled to the Benefit of Every Inference Which Can Reasonably Be Drawn From the Evidence Viewed Most Favorably to Him.

This was a jury trial. The trial court's ruling took the case from the jury, at the close of plaintiff's case in chief. The opinion of this Court states (page two) that the test on review is whether or not that ruling was "clearly erroneous."

Until the decision of this case we had not understood this to be the rule of review when a case is taken from the jury.

Time after time the Federal Courts have announced the rule in words similar to those used by this Court in *Kingston v. McGrath*, 232 F. 2d 495, 497 (1955) (Diversity jurisdiction, malpractice case):

"Upon appeal from a judgment of dismissal entered upon the close of a plaintiff's case-in-chief, the appellant is entitled to the benefit of every inference which can reasonably be drawn from the evidence viewed in the light most favorable to the claim or cause of action asserted. *Gunning v. Cooley*, 1930, 281 U. S. 90, 94, 50 S. Ct. 231, 74 L. Ed. 720; *Schnee v. Southern Pacific Co.*, 9 Cir., 1951, 186 Fed. 2d 745, 746; *Graham v. Atchison, T. & S. F. Ry. Co.*, 9 Cir., 1949, 176 Fed. 2d 819, 823; . . .

"As said in *Wilkerson v. McCarthy*, 1949, 336 U. S. 53, 67, 69 S. Ct. 413, 415, 93 L. Ed. 497:

‘It is the established rule that in passing upon whether there is sufficient evidence to submit an issue to the jury we need look only to the evidence and reasonable inferences which tend to support the case
* * *.’”

See also *Barron & Holtzoff*, 2 Federal Practice and Procedure 641 (1950); 5 Moore’s Federal Practice 231, for similar statements.

This Court has recently underscored the meaning of and necessity for the rule. *Smith v. Buck*, 245 F. 2d 348, 349 (1957) (diversity jurisdiction; negligence case):

“In considering a case of this kind, we should take note of the precedents established by the Supreme Court as to when it is proper to take a case from the jury. For although this is a diversity case, it was tried in a federal court where considerations relating to the Seventh Amendment must prevail. It is incumbent upon us to be guided by such cases as *Williams v. Carolina Life Insurance Co.*, 348 U. S. 802, 75 S. Ct. 30, 99 L. Ed. 633, and *Gibson v. Phillips Petroleum Co.*, 352 U. S. 874, 77 S. Ct. 16, 1 L. Ed. 2d 77.”

The opinion of this Court, in announcing a new rule for appellate review of judgments such as the one in this case, stands squarely in opposition to prior decisions of this Court, to the decisions of the other Courts of Appeal, and to the decisions of the United States Supreme Court (*cf. Jacob v. City of New York*, 315 U. S. 752, 753 (1942)).

Furthermore, the present opinion is at variance with *Kingston v. McGrath*, *supra*, 232 F. 2d 495, 497 (9th Cir. 1955), in other important particulars: Should the

motion be considered as made under Rule 50 or Rule 41? Perhaps the Court in this case, in holding that the motion for directed verdict was “properly treated” under Rule 41 (Op. p. 2) used the tests for dismissal applicable in non-jury cases. Moreover, the Court in this case is silent on lack of findings. They were not waived [Tr. 210]. They are required by Fed. R. Civ. Proc. 41(b) and Rule 52. The *Kingston* case, *supra*, at 497, comments on the failure to make findings in an indistinguishable situation.

The critical problem here is that the Court, in applying the “clearly erroneous” test did not give plaintiff the benefit of all the inferences from the evidence, construed most favorably in his favor. Under the Seventh Amendment it was bound to do so. Because the case turns on whether or not there was evidence of what was a reasonable time for acceptance of the offer (see, Op. pp. 6-7, 13. “There was no evidence introduced as to what the reasonable time is or should be . . .” (p. 7)), the method of review has resulted in the loss to appellant of federally guaranteed rights.

On the basis of the Court’s own opinion, the critical question is whether or not there was evidence of reasonable time. We submit that, if considered under the well-established rules of appellate review set forth above, plaintiff was entitled to have that question go to the jury. The evidence is considered under Point II, *infra*.

II.

Appellant Has Been Deprived of a Jury Trial on a Critical Issue of Fact: Had a Reasonable Time for Reply Elapsed Between the Date the Offer Was Communicated and the Date of the Fire.

We submit that unless the judgment is reversed, plaintiff will have been denied his rights under the Seventh Amendment. *Smith v. Buck, supra*, 245 F. 2d 348, 349 (9th Cir., 1957); *Jacob v. City of New York*, 315 U. S. 752 (1942).

The court holds that the plaintiff would be entitled to submit his case to the jury if there were some evidence of what was a reasonable time for acceptance or rejection of the offers for increased coverage (Op. pp. 6, 7, 13).

Love testified "that the custom was that if the applications (memoranda) were to be rejected, it was to be done 'at once' " [Op. p. 6; Tr. 156].

A. We submit that this testimony alone gave a content to what was a reasonable time. The words "at once" are not words of art. It is an everyday expression which the jury can evaluate as a question of fact. This court has previously had occasion to determine what the words mean:

"The Supreme Court of New Hampshire (*Ward v. Maryland Casualty Co.*, 71 N. H. 262, 51 Atl. 900, 93 Am. St. Rep. 514), in determining the meaning of the word 'immediate' used in a like sense as the words 'at once' in the present policy, has held that it signifies due diligence under the circumstances of the case, and without unnecessary and unreasonable delay, *and that whether the notice is so given is a question of fact*. This case has the express approval of the federal Supreme Court. Fidelity &

Deposit Co. v. Courtney, 186 U. S. 342, 346, 22 Sup. Ct. 833, 46 L. Ed. 1193." (Emphasis supplied).

Empire State Surety Co. v. Northwest Lumber Co., 203 Fed. 417, 420 (9th Cir., 1913).

Certainly the jury could have been instructed in the language of the *Empire State* case and come to an intelligent verdict.

See also, California Civil Code, Sections 1963(20) and 1961 (presumption that ordinary course of business has been followed).

Moreover, other evidence in the case gives content to the meaning of reasonable time. Love, it may be inferred from the evidence, thought the insurance was in force and therefore made no effort to place it elsewhere [Tr. 189-191]. One Court, in determining what the words "at once" meant held that it would be guided by the actual construction placed thereon by the persons concerned. *Christenson v. Gorton-Pew Fisheries Co.*, 8 F. 2d 689, 691 (2nd Cir., 1925). In this case there was evidence of the construction of at least one interested party. That construction favors plaintiff. The words themselves have content. The words were actually construed by a person familiar with the customs of the business and relied upon by him. Under these facts alone, plaintiff is entitled to a jury trial.

B. "The question of what constitutes an unreasonable delay which will imply an acceptance of the policy has generally been held to be a question of fact for the jury or the trial court acting as a trier of facts, under the particular circumstances of each case."

29 *Am. Jur.* 1957 Supp. p. 229.

Cases are collected at 32 A. L. R. 2d 501.

American Life Ins. Co. of Alabama v. Hutcheson,
109 F. 2d 424, 427 (10th Cir. 1940) (cert. den.,
310 U. S. 625).

C. As an alternative ground, we submit that California law imposed on the insurer a duty to speak. *Stark v. Pioneer Casualty Co.*, 139 Cal. App. 575, 580 (1934). The duty found in the *Stark* case is predicated on the public duty of insurers. The result follows here, *a fortiori*, where the applicant is *already* insured with the offeree. While the *Stark* case was based on negligence, this should not be a point of distinction. The case establishes a duty to speak within a reasonable time. As pointed out in *America Life Ins. Co. of Alabama v. Hutcheson*, *supra*, 109 F. 2d 424 (10th Cir., 1940), it makes little difference whether the theory is tort or contract. The Supreme Court of Wisconsin put it this way:

“ . . . courts have had more difficulty in ascertaining the correct basis of liability than in holding an insurer liable under such circumstances. . . . If the insurer is under such a duty [to act on the application] and fails to perform the duty within a reasonable time and, as a consequence, the applicant sustains damage, it is not vastly important that the legal relationship be placed in a particular category.”

Kukuska v. Home Mutual Hail-Tornado Ins. Co.,
204 Wis. 166, 235 N. W. 403 (1931).

D. There is a further ground for reversal in the interests of justice.

The judgment of the District Court was based on the ground that the terms of the offer were not spelled out in sufficient detail. [Tr. 204, 208.] The judgment of

the District Court was *not* based on lack of acceptance of whatever had been offered. Moreover, the trial judge made no findings of fact, contrary to the clear language of Federal Rules of Civil Procedure 41(b), and 52. [See Tr. 210.]

But the decision of this Court is based on lack of acceptance, *not* inadequacy of the terms of the offer. This is just the converse of the basis of the District Court judgment.

It requires no citation of authority to establish that one of the purposes of the motion of nonsuit under Rule 41(b) or for directed verdict under Rule 50(a), when made at the close of plaintiff's case, is to direct a party's attention to any deficiencies in his proof and accord him an opportunity to correct said deficiencies. (*Gile v. Duke*, 5 F. 2d 952, 953 (9th Cir., 1925) Rehr. den.).) This is the rule, also, under California law. (*Eatwell v. Beck*, 41 Cal. 2d 128, 133, 257 P. 2d 643 (1953). See, also, 2 Witkin, Calif. Proc., 1862-1863.) If a different rule exists in the federal courts, it would deprive a party of substantial rights and violate the rule of the *Erie* case, 304 U. S. 64 (1938).

By means of the two different rulings by the trial court and this court, appellant has been completely deprived of the benefit of this rule. It has turned out that appellant was right in his argument in the court below. The terms of the offer were sufficient. (*Parlier Fruit Co. v. Fireman's Fund Ins. Co.*, 151 Cal. App. 2d 6, 311 P. 2d 162 (1957) (Pet. for rehrg. den., pet. for hrg. by S. Ct. of Calif. den.).) He needed no additional evidence on those matters. *But the issue of what was a reasonable time within which to accept or decline was not argued*

by either side in the court below and appellant therefore never had an opportunity to present the additional evidence which this court now deems essential. For lack of such evidence on what was a reasonable time, this court now affirms the judgment of dismissal.

It seems to us that the fundamental concepts of justice and fair play require a reversal, so that the appellant may have an opportunity to meet the grounds on which the motion for directed verdict is now upheld.

Conclusion.

For the reasons stated, a rehearing should be granted and the judgment below reversed.

Respectfully submitted,

HARRY J. MILLER,

ROBERT HAVES,

By ROBERT HAVES,

Attorneys for Appellant.

Certificate of Counsel.

I, Robert Haves, counsel for Petitioner in the above entitled action, hereby certify that the foregoing petition for rehearing of this cause is presented in good faith and not for delay, and in my opinion is well founded in law and in fact, and proper to be filed herein.

ROBERT HAVES,

Attorney for Petitioner.

No. 15,322

IN THE

United States Court of Appeals
For the Ninth Circuit

WILLIAM T. PRICE,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR APPELLEE.

LLOYD H. BURKE,

United States Attorney,

JOHN H. RIORDAN, JR.,

Assistant United States Attorney,

RICHARD H. FOSTER,

Assistant United States Attorney,

422 Post Office Building,

Seventh and Mission Streets,

San Francisco 1, California,

Attorneys for Appellee.

FILED

JUL 15 1957

PAUL P. O'BRIEN, CLERK

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No. 15,322

IN THE

**United States Court of Appeals
For the Ninth Circuit**

WILLIAM T. PRICE,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

BRIEF FOR APPELLEE.

JURISDICTION.

Jurisdiction is invoked under Section 1291 of Title 28 United States Code.

STATEMENT OF THE CASE.

Appellant was indicted on October 5, 1955, for violation of Section 174 of Title 21 United States Code, unlawful concealment of heroin. He plead not guilty, and was tried by jury before the Honorable George B. Harris, United States District Judge. After a jury verdict of guilty, and the filing of a prior conviction Information, charging two prior convictions of

a narcotic law, appellant was sentenced to a term of 20 years.

The evidence established that on September 30, 1955, Narcotic Agents, after first securing a search warrant and a warrant of arrest, entered the defendant's apartment at 1502 McAllister Street, San Francisco (Tr. 11-12). The appellant was lying on the bed when the agents entered the room. A homemade type stand was sitting alongside the bed the defendant was lying upon, and on this stand was a bindle of 13 grains of heroin (Tr. 5, 13 and 14). At the time this heroin was seized Agent Stenhouse of the Federal Bureau of Narcotics testified the defendant stated in reply to his question as to how the bindle got there, "It was a miracle that we found the stuff as he had only purchased it about 20 minutes before we had come into the room, and that he was just going to a party with it and the girls (Tr. 15). The defendant refused to identify the source of the narcotics (Tr. 15).

At the time of appellant's arrest a bindle of narcotics was found on the person of the woman with whom he shared the apartment (Tr. 38). Appellant told Agent Stenhouse that the bindle found on the person of the woman with whom the appellant shared the apartment "was the same or some of the same stuff that he had bought; that he had placed it in another bindle." (Tr. 15-16).

In the kitchenette, in plain sight, Police Officer Getchell found a hypodermic injection kit on a baseboard (Tr. 38-39).

Appellant took the stand in his own defense, and admitted that he rented the residence in which the arrest took place with his co-defendant Tony Raven (Tr. 79). He claimed that the narcotics were purchased by the same Tony Raven. He admitted being present when the narcotics were delivered (Tr. 80-81). He also admitted that he used narcotics on occasion (Tr. 81). He also admitted that he told Agent Stenhouse it was a miracle that they had found it "because, you know, usually we would use it up and forget about it." He denied, however, concealing the narcotics (Tr. 86).

In his opening statement counsel for the government stated:

"Federal Narcotics Agents, armed with the search warrant, went to the number on McAllister Street and entered the premises and arrested the defendant and another person who is not engaged in this indictment. They arrested them and on each of these persons found narcotic drugs, and in particular right alongside of the defendant's bed lay a bundle of narcotic drugs, to-wit, 13 grains which we have charged."

QUESTIONS PRESENTED.

1. Did the prosecuting attorney commit prejudicial misconduct?
2. Is the evidence sufficient?

ARGUMENT.

I. THE OPENING STATEMENT OF GOVERNMENT'S COUNSEL WAS PROPER.

Mr. Riordan, counsel for the government, stated in his opening statement that the evidence would disclose that narcotic drugs were found on the night stand located near the bed in which appellant was lying. Appellant claims that counsel for the government "knowingly submitted perjured testimony to the court" in so doing. To begin with, of course, the government's opening statement is not testimony at all. Furthermore, Mr. Riordan's statement as to what the evidence would show is borne out by the testimony.

The particular portion of Mr. Riordan's statement to which appellant objects consists of one sentence, which reads as follows, "They arrested them and each of these persons found narcotic drugs and in particular alongside the defendant's bed lay a bundle of narcotic drugs, to-wit, 13 grains which we charged."

This statement was, of course a correct forecast of what the evidence in fact showed. The statement was accurate and not prejudicial in any way. It takes no citation or authority to demonstrate that appellant's argument is completely without merit.

II. THE EVIDENCE WAS SUFFICIENT.

Appellant was charged with concealing approximately 13 grains of heroin on September 30. On September 30, pursuant to a search warrant and a warrant of arrest federal narcotic agents entered the defend-

ant's apartment. They found next to him on a nightstand, near the bed on which he was lying, 13 grains of heroin (Tr. 13-14). The defendant was asked where it came from, and he replied he had purchased it 20 minutes before (Tr. 15). Furthermore, he admitted that other narcotics found on the person of the woman, who shared the apartment with him, came from the same source (Tr. 15-16). A hypodermic needle was found in plain sight in the defendant's kitchenette (Tr. 38-39).

Appellant admitted at the trial that he knew the narcotics were there (Tr. 80-81). He further stated that if the agents had got there much later it would not have been there, "because we would use it up and forget about it" (Tr. 86). The evidence was more than sufficient, and the jury was practically compelled by the evidence to find the defendant guilty.

CONCLUSION.

The evidence was sufficient and no error has been shown in the trial. The judgment should be, therefore, affirmed.

Dated, San Francisco, California,

July 15, 1957.

LLOYD H. BURKE,

United States Attorney,

JOHN H. RIORDAN, JR.,

Assistant United States Attorney,

RICHARD H. FOSTER,

Assistant United States Attorney,

Attorneys for Appellee.

No. 15326

**United States
Court of Appeals**
for the Ninth Circuit

RALPH E. WILLIAMS, as Trustee of the Estate
of FUTURE MFG. COOPERATIVE, INC.,
Bankrupt,

Appellant,

vs.

LEAMON T. McDONALD,

Appellee.

Transcript of Record

**Appeal from the United States District Court for the
Northern District of California
Southern Division.**

FILED

DEC 14 1956

PAUL P. O'BRIEN, CLERK

No. 15326

United States
Court of Appeals
for the Ninth Circuit

RALPH E. WILLIAMS, as Trustee of the Estate
of **FUTURE MFG. COOPERATIVE, INC.**,
Bankrupt,

Appellant,

VS.

LEAMON T. McDONALD,

Appellee.

Transcript of Record

Appeal from the United States District Court for the
Northern District of California
Southern Division.

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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in *italic*; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in *italic* the two words between which the omission seems to occur.]

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Witnesses:

Aaronson, Daniel, Jr.

—direct 23

McDonald, Leamon T.

—direct 12

NAMES AND ADDRESSES OF COUNCIL

SHAPRO & ROTHSCILD,

155 Montgomery Street,
San Francisco,

For Appellant.

L. T. McDONALD,

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Cupertino, California,
(Pro Per),

For Appellee.

In the Southern Division of the United States District Court for the Northern District of California

No. 35489—Civil Action

RALPH E. WILLIAMS, as Trustee of the Estate
of Future Mfg. Cooperative, Inc., Bankrupt,
Plaintiff,

vs.

LEAMON T. McDONALD,
Defendant.

COMPLAINT TO RECOVER PREFERENCE

Complaining of defendant above named, plaintiff alleges:

I.

That this Court has jurisdiction over the subject matter of this action under the provisions of Section 60(a)-(b) of the Bankruptcy Act.

II.

That heretofore and on the 30th day of January, 1956, Future Mfg. Cooperative, Inc., filed in the above-entitled court a voluntary Petition in Bankruptcy; and that thereafter, by order of the above-entitled court regularly made and entered in said bankruptcy proceedings, said Future Mfg. Cooperative, Inc., was duly adjudged a bankrupt; and that thereafter such proceedings were regularly and duly had before the above-entitled court as that

plaintiff was duly appointed as and thereafter duly qualified as and ever since has been, and still is, the duly appointed, qualified, and acting Trustee of the estate of the bankrupt above named.

III.

That within four months of the filing of said Petition in Bankruptcy, and more particularly on or about the 4th day of January, 1956, said bankrupt, while then and there insolvent, transferred a portion of its property, to wit: The sum of One Thousand Seven Hundred Seventy-six (\$1,776.00) Dollars to Defendant; and that at the time of the aforesaid transfer Defendant was a general and wholly unsecured creditor of said transferor; and that said transfer was so made with the intent to and with the effect of preferring Defendant over the other then existing and wholly unsecured creditors of said transferor in that the effect of said transfer was to enable said Defendant to obtain payment of a greater percentage of his claim against said transferor than did other of his creditors of the same class; and that at the time of the said transfer and payment, Defendant well knew and/or had reasonable cause to believe that said transferor was insolvent and that the effect of said transfer and payment would be to so enable said Defendant to obtain such preference.

IV.

That other general and wholly unsecured creditors of said bankrupt have heretofore proved and filed against its bankrupt estate their several

proofs of claim, and that the assets of said estate are insufficient to pay such unsecured claims of said creditors in full.

V.

That notwithstanding that the Plaintiff demanded said sum of One Thousand Seven Hundred Seventy-six (\$1,776.00) Dollars, Defendant has failed, refused and neglected and still fails, refuses and neglects to pay said sum to Plaintiff.

Wherefore, Plaintiff prays judgment against the above-named Defendant in the sum of One Thousand Seven Hundred Seventy-six (\$1,776.00) Dollars, plus legal interest thereon from and after January 4, 1956, and for Plaintiff's costs herein incurred, and for all proper relief.

/s/ RALPH E. WILLIAMS.

SHAPRO & ROTHSCHILD, and
JAMES M. CONNERS.

Duly verified.

[Endorsed]: Filed May 17, 1956.

[Title of District Court and Cause.]

COMPLAINT TO RECOVER PREFERENCE
ANSWER

L. T. McDonald answers the first cause of action as follows:

L. T. McDonald denies the alleges of the first cause of action and denies that any sum at all is due from him to the Plaintiff.

L. T. McDonald answers the second cause of action as follows:

Wherefore L. T. McDonald, prays that judgment will be for him with his costs.

/s/ LEAMON T. McDONALD.

Defendant,

Duly verified.

[Endorsed]: Filed June 23, 1956.

[Title of District Court and Cause.]

ORDER FOR JUDGMENT

Judgment may enter for defendant upon findings, presented pursuant to the rules.

Dated: August 2, 1956.

/s/ LOUIS E. GOODMAN,

United States District Judge.

[Endorsed]: Filed August 3, 1956.

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above-entitled action having regularly come on for trial on the 2nd day of August, 1956, before

the above-entitled Court, sitting without a jury, Plaintiff being represented by Messrs. Shapro & Rothschild and James M. Connors, Esq. (Daniel Aronson, Jr., Esq., appearing), his attorneys, and Defendant, Leamon T. McDonald, appearing in person and not being represented by counsel, and the Court having heard the testimony both oral and documentary adduced by the respective parties, having examined the witnesses, and the cause having been duly argued and submitted for decision and the Court being fully advised in the premises, now makes these Findings of Fact and Conclusions of Law as follows:

Finding of Fact

I.

That each and all of the allegations contained in paragraphs I, II, IV and V of Plaintiff's Complaint are true.

II.

That each and all of the allegations contained in paragraph III of said Plaintiff's Complaint are true, saving and excepting the words "Defendant well knew and/or had reasonable cause to believe that said transferor was insolvent." and that said exception is untrue.

Conclusions of Law

I.

That the payment by the Bankrupt to the Defendant of the sum of \$1,776.00 within four months

next preceding the filing of the petition in bankruptcy by said Bankrupt on the 30th day of January, 1956, was not a voidable preference under Section 60(b) of the Bankruptcy Act, and that said Defendant did not have knowledge or reasonable cause to believe that said Bankrupt was insolvent at the time of said payment.

II.

That Plaintiff is not entitled to recover the said sum of \$1,776.00 from Defendant.

Let judgment be entered accordingly.

Dated in San Francisco in said District this 27th day of August, 1956.

/s/ LOUIS E. GOODMAN,
District Judge.

Lodged August 15, 1956.

[Endorsed]: Filed August 27, 1956.

In the Southern Division of the United States District Court for the Northern District of California

No. 35489

RALPH E. WILLIAMS, as Trustee of the Estate
of FUTURE MFG. COOPERATIVE, INC.,
Bankrupt,

Plaintiff,

vs.

LEAMON T. McDONALD,

Defendant.

JUDGMENT

The above-entitled action having regularly come on for trial on the 2nd day of August, 1956, before the above-entitled Court, sitting without a jury, Plaintiff being represented by Messrs. Shapro & Rothschild and James M. Connors, Esq. (Daniel Aronson, Jr., Esq., appearing), his attorneys, and Defendant, Leamon T. McDonald, appearing in person and not being represented by counsel, and evidence, both oral and documentary, having been adduced by the respective parties upon the issues joined by the Complaint of Plaintiff herein and the Answer thereto filed herein by said Defendant, and the matter having been duly argued and submitted to the Court for decision and the Court having heretofore made, signed and filed herein its Findings of Fact and Conclusions of Law, and good cause appearing therefore,

It is hereby ordered, adjudged and decreed that judgment be entered for the Defendant herein, that Plaintiff take nothing by his complaint and that Defendant recover his costs herein incurred, and taxes at the sum of \$———.

Dated at San Francisco in said District this 27th day of August, 1956.

/s/ LOUIS E. GOOMAN,
District Judge.

Lodged August 15, 1956.

[Endorsed]: Filed and entered August 27, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

Notice is hereby given that Ralph E. Williams, as Trustee of the Estate of Future Mfg. Cooperative, Inc., Bankrupt, Plaintiff, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the final judgment entered in this action on August 27, 1956.

Dated: This 29th day of August, 1956.

SHAPRO & ROTHCHILD, and
JAMES M. CONNERS,

By /s/ DANIEL ARONSON, JR.
Attorneys for Plaintiff.

[Endorsed]: Filed August 29, 1956.

The United States District Court Northern District
of California, Southern Division

No. 35489

RALPH E. WILLIAMS, as Trustee of the Estate
of FUTURE MFG. COOPERATIVE, INC.,
Bankrupt,

Plaintiff,

vs.

LEAMON T. McDONALD,

Defendant.

Before: Hon. Louis E. Goodman, Judge.

REPORTER'S TRANSCRIPT

Appearances:

For the Plaintiff:

SHAPRO & ROTHSCHILD, by

For the Defendant:

DANIEL AARONSON, JR.,

In Propria Persona.

Thursday, August 2, 1956

The Clerk: Williams vs. McDonald.

Please state your appearances for the record.

Mr. Aaronson: Daniel Aaronson, Jr., of Shapro
& Rothschild appearing for plaintiff.

The Clerk: Please state your name.

Mr. McDonald: Leamon Thomas McDonald.

The Court: You do not have an attorney, Mr.
McDonald?

Mr. McDonald: No, sir.

The Court: You have not had an attorney at all in this proceeding?

Mr. McDonald: No, sir.

The Court: Do you want to proceed with this case without an attorney?

Mr. McDonald: Yes, sir.

The Court: All right; you may sit down.

Mr. Aaronson: May I first thank the Court for inconveniencing itself to get this matter disposed of?

This is a complaint to recover preference, brought by the Trustee of the Estate of Future Mfg. Co-operative, Inc., Bankrupt, against Leamon T. McDonald, who was the president of the bankrupt corporation. We are concerned with the sum of \$1,776, which is the alleged preference received by Mr. McDonald. [3*]

The trustee plaintiff will call Mr. McDonald as a witness.

LEAMON T. McDONALD

The defendant herein, called as a witness on behalf of the plaintiff; sworn.

The Clerk: Please state your name for the record.

A. Leamon Thomas McDonald.

Direct Examination

By Mr. Aaronson:

Q. Mr. McDonald, you are the defendant in this action? A. Yes, sir.

(Testimony of Leamon T. McDonald.)

Q. And you were the president of the bankrupt corporation? A. Yes, sir.

Q. And you were also the general manager and the operator of the business? A. Yes, sir.

Q. And the business of the corporation was destroyed by fire, was it not? A. Yes, sir.

Q. And when was that?

A. On January 2nd, this year.

Q. That was the morning of January 2nd?

A. Yes, sir.

Q. And on or about the 3rd or 4th of January you received a certain sum of money in excess of \$1900? [4] A. Yes, sir.

Q. What did that money represent?

A. It represented the receipts for the past week of the store.

Q. Of the operation of the business before the fire? A. Yes, sir.

The Court: What was the date? I didn't get the date.

Mr. Aaronson: That he received the money, your Honor?

The Court: Yes.

Mr. Aaronson: It was the 4th of January.

The Witness: About the 4th of January.

The Court: And when was the fire?

Mr. Aaronson: On the 2nd.

The Court: All right; go ahead.

Q. (By Mr. Aaronson): You previously testified under oath before the referee in the bankruptcy proceeding; is that correct? A. Yes.

(Testimony of Leamon T. McDonald.)

Q. And you furnished a statement concerning the disposition of those 1900 odd dollars?

A. Yes.

Q. And it was your testimony that of the 1900 odd dollars you took \$1,776 for yourself for back wages?

A. Yes, sir.

Q. Those were for wages prior to the [5] fire——

A. Yes, sir.

Q. ——for which you had not been paid? Then on the 30th of January, 1956, you filed for the corporation, through your attorneys, a petition in bankruptcy.

A. Yes, the Board of Directors did, yes, sir.

Q. I will show you the petition and ask you if that bears your signature.

A. Yes, sir.

Q. And at the time that you filed the petition you filed only a list of your creditors?

A. Yes, sir.

Q. And then at a later date the corporation filed the Schedules A and B showing the assets and liabilities?

A. Yes, sir.

Mr. Aaronson: If I may, your Honor, I will offer in evidence the petition and schedules as Trustee's No. 1.

The Court: All right.

The Clerk: Plaintiff's Exhibit No. 1 introduced and filed into evidence.

(Whereupon schedules and petition referred to above were received in evidence and marked Plaintiff's Exhibit No. 1.)

(Testimony of Leamon T. McDonald.)

Q. (By Mr. Aaronson): The business did not operate after the fire; is that correct, Mr. McDonald?
A. No, sir. [6]

Q. And so the situation with regard to the finances of the corporation on January 4th was identical with January 30th.
A. Yes.

Mr. Aaronson: I will call your Honor's attention to the summary page of the schedule indicating total liabilities of \$83,147.14 and assets of \$44,004.96.

The Court: What kind of a business was it?

Mr. Aaronson: A grocery store.

The Court: Grocery business?

The Witness: Yes.

The Court: Retail or wholesale grocery?

A. Retail.

Q. (By Mr. Aaronson): Under date of April 18th, Mr. McDonald, you received a letter signed by myself demanding repayment of the \$1,776.

A. Yes, sir.

Q. And you did not reply to that?

A. No, sir.

Q. The next action you knew was when the complaint was served upon you?
A. Yes, sir.

Mr. Aaronson: I have nothing further of this witness.

The Court: Did you wish to ask yourself any questions or make a statement about the matter? [7]

The Witness: Your Honor, I would like to make a statement about the matter.

(Testimony of Leamon T. McDonald.)

Your Honor, I am being the president of the organization—it was a co-op—and chairman of the Board of Directors and also the employee in the store.

April 1st of last year or thereabouts we started the business. The Board of Directors had me leave my present job—I am a refrigeration serviceman—and take over the management in the store and take care of the purchasing in the store. I was supposed to get \$75 a week and my groceries, \$25. I have seven in the family.

The wife and I worked many long, hard hours for the store, as the store was new, and we remodeled and brought it up. And I filed an income tax for this year. I had taken, including the \$1700, \$2700 less my \$25 for groceries.

But when the fire happened, we talked it over with the secretary and treasurer and Mr. Jim Brand, Vice-President of the corporation who handled all the money and paid all the bills. And I hadn't been paid and my family had gone without in order to see that the creditors and the employees—the other employees—got paid. And we paid all the labor due the manager and assistant manager we had in the store, and the helper, and I take the rest for my pay. So I took it.

We hadn't planned any bankruptcy whatever. It hadn't even been discussed with anyone that I know of. Now we have [8] a Board of Directors. There was a little dissension in the Board of Directors, but I had made arrangements with our at-

(Testimony of Leamon T. McDonald.)

torney, Mr. Reinheimer, already to see if we couldn't get the store rebuilt and get back, and I had talked to the main creditors, the grocery people and the fixture company.

The fixtures were redeemable; in other words, they could be put back in order, and the groceries we had planned to sell on a fire sale and they would replace them.

All right. I had stood guard on the grocery store for about two weeks after the fire in order—it had been raining very heavy, and the inventory people couldn't get in there to take inventory as fast as they thought they could. Well, as soon as the inventory, we were going to put a fire sale on, sell it out and try to get back into business.

The Court: Was there insurance?

A. Yes, there was insurance, some sixteen or eighteen thousand dollars; I don't remember right now.

All right. Then we had the attorney working on it to see how we stood and how the owner of the property felt about putting us back in, and about two weeks—the next thing I knew, the attorney had called a meeting. We had gone down and set aside a sum of money by a resolution setting aside the attorney's fees and a fee for taking inventory, and we turned it over to the attorneys to administer the estate; in other words, to see that the money [9] was handled properly and the creditors got their share.

Myself, I had no intentions of going through bankruptcy, and I think the majority of the direc-

(Testimony of Leamon T. McDonald.)

tors had no intentions, because we are laymen, we know nothing about bankruptcy proceedings and what it held; we were depending on our attorney to a degree.

About two or three weeks later I was confronted with the papers that I have my signature on there now to file bankruptcy. I was not notified of the hearing whatsoever. The attorney called a meeting on Sunday and he had the—had all the other directors agreeing that they should homestead their homes, they should pay him \$25 for homesteading their homes, and they should pay him \$150 apiece for taking them through personal bankruptcy, which this has never happened.

All right. Here come the secretary and treasurer with the papers for me to sign, and I knew nothing of it whatsoever. I refused to sign them, because we hadn't planned it like that. So I went the papers back, and about the next night or two here come Reinheimer out to my house with the papers. While he is trying to convince me that I should sign the bankruptcy papers and we should put it through bankruptcy, why, the secretary and treasurer comes in. And when the secretary and treasurer found out that he had called a meeting without my knowledge—he had told the directors that I knew all about it, which I knew nothing—he apologized before [10] my wife, and the secretary and the treasurer and Mr. Jim Brand, who was here with me a little bit ago, said that they had to protect themselves. I mean that is pretty rotten, in my opinion, without

(Testimony of Leamon T. McDonald.)

any discussion or without letting us on the Board of Directors discuss it after him talking to us. He just more or less scared them into it.

Well, two or three days went by, and after I had talked to a few of the directors, I just gave and said, "O.K., we will put it through bankruptcy," because I had worked hard; my family had gone without all those months in order to try to build the business, to pay our way.

I have the receipts for the \$1700, and they are all dated that date. I had to move from my home. I had to have a place to move immediately. My car had been——

The Court: What is this \$1700?

A. Wages—back wages.

Q. That hadn't been paid?

A. That hadn't been paid. I had put it back to cash the checks and to see that the other employees got paid.

Q. How much time did that cover?

A. Well, that covered off and on from the time I went to work.

Q. You mean you hadn't drawn your full salary, is that what you mean?

A. Yes. Sometimes I let my whole week go by without [11] drawing anything if I could get by.

Q. Is there any record of the payments that were made? A. Yes.

Q. Where was that?

A. With the books, and they have the books. My

(Testimony of Leamon T. McDonald.)

record of the money that was paid me and the money that was taken is right in there.

Q. This \$1700 was the balance that was owing you that had not been paid over various periods of time?

A. That was a portion of it. To figure it up, the amount of money that I had coming, that didn't cover it all by any means.

Q. You had more than \$1700 coming to you in wages? A. Yes, and \$75 a week.

The Court: Anything else?

A. Well, that's it.

The Court: Do you want to ask any questions?

Mr. Aaronson: Yes, I would, your Honor.

Q. Mr. McDonald, were you advised by your counsel not to convert the \$1900 to your use?

A. No, sir.

Mr. Aaronson: With regard to the time element, your Honor, the exhibits will show that they were subscribed and sworn to by Mr. McDonald on the 16th of January, and that the resolution in support of the petition was adopted on the [12] 15th of January. So the time element was less than two weeks after the fire, and there was one day intervening between the time the schedules were filed.

I might say just for the record that the petition was actually presented on the 16th or 17th—the 17th or 18th, rather—but Mr. Reinheimer presented only the petition without the supporting list of creditors, and that involved the delay to the 30th.

Q. Prior to the time that the petition was filed,

(Testimony of Leamon T. McDonald.)

Mr. McDonald, didn't you have conversation with Mr. Reinheimer concerning the question of the corporation filing a voluntary petition in face of the fact that the creditors were going to file an involuntary?

A. We had general discussions about the business and its operations, but nothing concerning a definite bankruptcy whatsoever. The only that that may have been discussed about bankruptcy was as a possible way out, and the brief talks that I may have had with him, in trying to remember the exact words, I think I said, "Well, we'll see" or "We'll think about it," because we had no intentions of bankruptcy because we had this fire sale coming up and everything else.

Mr. Aaronson: I have no further questions.

The Court: Who put up the money for this business?

A. Well, the money was largely put up by the directors, as it was a co-op, you know. The people—there wasn't a lot [13] of money put up; what money was put up—I put up all that I could get together—

Q. How many people were joined in this co-op?

A. There were about 50 active people.

Q. 50? A. Yes.

Q. And did every one of the 50 put up some money?

A. Some, yes; anywhere from 10 to, oh, maybe a hundred dollars; I mean from time to time.

Q. What was the total amount that was invested

(Testimony of Leamon T. McDonald.)

in the business by everybody, approximately? Do you know that?

A. Well, I imagine there is probably around—actual cash, maybe three or four thousand dollars. I doubt if there was any more than that.

Q. With that capital how were you able to start the grocery business? Did you get credit?

A. Well, here is what happened, sir. The store that we had went into the hands of the receivers, and the manager of the store who had the lease was a relative of one of the Board of Directors. So he approached us in taking it over. So we went to the receivers here in San Francisco and they consented to changing hands. Let's see—we put in \$3,000 cash——

Q. It was an operating grocery store?

A. Yes. [14]

Q. Who was operating it?

A. Mr. Bill Shrader.

Q. And he was in trouble?

A. Yes, he was in trouble and I'll—the son-in-law of Mr. Bill Shrader put up \$3000 in order to move into the grocery store. I mean that was the agreement between the receivers. And then the balance that was in the hands of the receiver was to be paid off at a certain date, or as we went along.

Q. When did you go in there?

A. In April of last year.

Q. Of 1955? A. Yes.

Q. How many employees were there?

(Testimony of Leamon T. McDonald.)

A. Well, myself and two grocery employees and a butcher—one butcher.

Q. Did those three also contribute to it?

A. No, they were employees.

Q. They were just employees?

A. They were paid.

The Court: Anything else you want to bring out?

Mr. Aaronson: Not from this witness, your Honor.

The Court: That is all. You can step down.

(Witness excused.)

Mr. Aaronson: I would like to be sworn, your Honor. [15]

DANIEL AARONSON JR.

called as a witness on behalf of the plaintiff; sworn.

The Clerk: Please state your name for the record.

A. Daniel Aaronson, Jr.

The Witness: I have, your Honor, in my possession here 43 claims, all original claims on file with the referee in bankruptcy. I had intended to obtain a certificate to place in evidence from the referee, but he has been on vacation. So therefore I obtained the original claims filed from the referee, and I have made a list of claims filed to and including January 27, 1956. I have broken them down into three categories: The unsecured claims, the priority tax claims, and priority labor claims.

(Testimony of Daniel Aaronson, Jr.)

I have also made a notation on the list that the time for filing does not expire until September 16th.

I would offer into evidence the claims and ask that the list be substituted in the file.

The Clerk: Plaintiff's Exhibit 2 introduced and filed into evidence.

(Whereupon list of claims was received in evidence and marked Plaintiff's Exhibit No. 2.)

The Court: What is the total?

A. I have the total here. The list of unsecured claims total \$18,784.61; the priority labor claims, \$1,212.85; and the priority tax claims, \$373.82, and the Director of [16] Internal Revenue has not yet filed his claim. We understand it will be a substantial claim.

From the claims that are filed, your Honor, and from Plaintiff's Exhibit No. 1, the schedules, you will observe that there are labor claims which were not paid of a substantial nature, both on a priority basis and unsecured basis. The trustee has received and has on hand only the sum of \$15,740.93, which is the balance that he has in his possession from the proceeds of the insurance policies—the fire insurance policies.

The only items that have been paid so far involved in actual expenses have been the inventory and so on to obtain the monies from the insurance company, and actual court costs, the court reporters on the various hearings heretofore held. It is my

(Testimony of Daniel Aaronson, Jr.)

recollection that we received just under \$16,000 for the total loss.

Q. The insurance companies then were subrogated; they had the right then to dispose of the merchandise?

A. That is correct, your Honor. There was some salvageable merchandise of a value possibly of two or three thousand dollars. It is difficult to definitely ascertain it because the labels were so badly damaged following the fire—the rains continued for some time, and what the fire didn't do the elements did—so we considered that it would be more advantageous to the creditors to take a full settlement and [17] let the insurance company make the salvage rather than our conducting the salvage sale.

Q. So the assets in the hands of the trustee are in sufficiency to pay the presently filed claims plus the expenses of administration? A. They are.

Q. Plus tax claims that have been filed?

A. That is correct, your Honor. The money that we received, insofar as I know at this time—unless further matters develop before the case is closed there will be no further recoveries except a possible recovery in this case, and the monies on hand are insufficient to pay the general secured creditors, without regard to any of the priority claims or expenses of administration.

The Court: Did you wish to ask any questions? You have a right to ask any questions you wish.

Mr. McDonald: Yes, I would just like to ask him—these labor claims that are there, these labor

(Testimony of Daniel Aaronson, Jr.)

claims are filed by the members of the co-op, aren't they, who contributed time rather than as an employee; they put in time perhaps like coming over at night and helping with the groceries? Because all other labor claims were paid.

A. The proof of priority wage debt to which I referred was claim No. 17, which was filed by the Labor Commissioner on behalf of Salmon, nature of work, carpenter; Cantu, grocery [18] clerk; Garcia, grocery clerk; Hale, grocery manager; Hale again as managing clerk; and Gilbert as meat cutter.

The proof of wage debt, the general claim, involves exactly the same people for periods of time more than 90 days prior to the filing of the petition. It is my recollection—may I see Exhibit No. 1, please? From Schedule A-1, all debts listed under priority, Gilbert, Salmon, Cantu, Garcia, McDonald, Brand, Wolf, Hale, Jones—Jones, Floyd and Jones, Shirley. They were all listed as wage claimants.

Q. (By Mr. McDonald): So these were approved and brought to the hearing by the Labor Commissioner and sent down with the proof that these were legitimate claims as wages?

A. Assuming that the Labor Commissioner followed his usual procedure, yes.

Q. I don't recollect having attended any hearing or been notified of any hearing that we owed any wages. Again, those wages are for time that they spent as volunteer and hoped that some time they

(Testimony of Daniel Aaronson, Jr.)

would get paid, because most of them were members——

The Court: They were not regular employees?

Mr. McDonald: A couple of them there are. I recognized the name Garcia; but at the same time he may have come in and did some work. Mr. Hale has no right because he was paid in full.

The Witness: Apparently there is a [19] question.

The Court: These labor claims would affect the result of a deficit.

A. I might say parenthetically, your Honor, insofar as this case is concerned, that at the first meeting of creditors there was, I know, Garcia and at least one of the other labor claimants, that those labor claimants were represented by counsel, and it would be the trustee's position, I am sure, before the Court that these claims be paid on a priority basis, or otherwise there will be a hearing before the referee to determine whether or not they are actually entitled to priority as wages, or as a matter of fact to any claims whatsoever.

I might say, your Honor, I personally placed the list of general unsecured creditors first to show that they would total more than the money spent.

Mr. McDonald: I would like to ask just one more thing. You say that this petition—the resolution was on the 15th and it was signed on the 16th. Do you know what date that could have been?

A. No.

(Testimony of Daniel Aaronson, Jr.)

Q. The meeting was held on Sunday?

A. That is correct. I checked it. The 15th is a Sunday—was a Sunday.

Q. And the papers were brought out to me Monday or Tuesday and I refused to sign. [20]

A. Yes.

Q. The attorney came out a night or two later, and then I finally came to his office and signed. Now how can it be the resolution on Monday and signed on the next?

The Court: What is the date that it was filed?

A. It actually was filed on the 30th, but it was subscribed and sworn to on the 16th. I am taking my information only from the schedules in this court.

The Court: The defendant contends he signed the papers but at a later date.

Mr. McDonald: Yes, I did, sir, because I thought it over——

The Witness: I can't say that.

Mr. McDonald: ——and talked to them about the thing two or three days before I signed. I have a witness right there.

The Court: Is there anything else you wanted to ask him?

Mr. McDonald: I don't think so.

Mr. Aaronson: I have nothing further, your Honor.

The Court: Is that all the evidence?

Mr. Aaronson: That is.

The Court: Mr. Aaronson, there is no evidence

that would justify that this money was taken with knowledge of bankruptcy.

Mr. Aaronson: Insolvency, not bankruptcy. The witness testified that there was no operation subsequent to the fire [21] and that the assets and liabilities of the corporation were exactly the same at the time of the fire, which was before the taking of the money, as they were at the time of the filing of the petition. The schedules show almost two to one on the liability side.

And I might further add that an examination of the B side of the schedules, the assets, will show \$24,000 set up as property—personal property and equipment—of which there was none, other than a few items, which incidentally are listed as amounts unknown, which were not on the premises destroyed by the fire, and also include the \$1,900 that Mr. McDonald got. So if you reduce that, you have 80 odd thousand dollars, less——

The Court: On the figures, yes, but the witness has testified that they thereafter were intending to continue with the business, which would not indicate an insolvency. You put him on. That is his testimony.

Mr. Aaronson: I appreciate that, your Honor; but the question of insolvency is the excess of the liabilities over the assets.

The Court: That is true, but in recovering a preference the burden is to show——

Mr. Aaronson: Reasonable cause to believe they were solvent.

The Court: —reasonable cause to believe that the [22] concern was insolvent.

Mr. Aaronson: Mr. McDonald testified only that they were going to try to continue on, and he was president and operated the business, and he well knew the condition of the business, and that there was no operation, so that the business, as the records show in the schedules, was in exactly the same condition at the time the petition was filed as it was at the time he took the money.

The Court: The only circumstance is that this \$1,700 was paid after the fire when the business was inoperative. That is the only circumstance.

Mr. Aaronson: I might say—

The Court: I have grave doubts as to whether or not there would be a preponderance of evidence that would be sufficient to warrant a finding that that was a preferential payment under the statute. There is a slimness of any evidence except the circumstance that here was a business that was apparently going along, then there was a fire, and then it was closed down for a time, and this man says he needed the money because he had been devoting himself to operating this business, so he took the back salary at that time. I have doubts as to whether or not that circumstance is sufficient to warrant the inference that he took the money at that time with the awareness that the business was insolvent and that the effect of what he was doing was getting [23] a preference over somebody else.

Mr. Aaronson: I think, your Honor, being the president and operator of the business, the general

manager of the business, he was well aware of the condition of the business. On two points the cases are quite clear that an officer of the corporation is presumed to know the condition of the corporation, particularly when he deals with it, and No. 2, that——

The Court: What does the record show as to what this \$1,700—what do the books show as to what it was on payment of?

Mr. Aaronson: The books show nothing as to what it was in payment of, your Honor.

The Court: What do the books shows as to what was owing to him?

Mr. Aaronson: What was owing to Mr. McDonald?

The Court: Yes.

Mr. Aaronson: Leamon T. McDonald, employed as clerk and manager for three months, October 10, 1955, to December 31, 1955, \$375.

The Court: What is that? \$375 owing?

Mr. Aaronson: That is owing, your Honor. I will look further. That was listed under the priority wage—as a priority wage, which it would be for the most part. Actually only two-thirds of that would be on a priority [24] basis.

The Court: At least part of the \$1,700 would have been proper for priority.

Mr. Aaronson: You say would have been proper, your Honor?

The Court: I say at least some part of the \$1,700 if he didn't receive it would have been allowable as a priority.

Mr. Aaronson: As a priority, yes, there is no question about that.

The Court: Isn't there a strong inference from that this this was not a preferential payment, then, within the meaning of the statute?

Mr. Aaronson: No, I don't believe so, your Honor.

The Court: It is some evidence.

Mr. Aaronson: I don't believe so, because in order for him to be paid on a claim filed in bankruptcy proceedings, he would have to surrender any preference he might have received, and if it was for an antecedent indebtedness——

The Court: That is true; but I am speaking now as some evidence on the question of whether or not the intent was to get a preference.

Mr. Aaronson: There is a possibility that a portion of it, perhaps the last week, might not be considered preferential, because he was entitled to take it out week by week. But beyond that, I think it is an antecedent indebtedness [25] for which there must be——

The Court: There is a very slim record here, Mr. Aaronson, and it doesn't seem to me to be sufficient to warrant adjudging a repayment of this as a preference. The only circumstance is that after the fire and before anything further was done, then he received the past due wages that were due him. That is all that the record shows.

Now we would have to indulge in the assumption at that time that that payment was made that the concern was insolvent; that he knew it was insol-

vent; that he took this money and got this money knowing that he was being preferred to other creditors at the time.

Mr. Aaronson: I think that is what the record shows, your Honor, exactly.

The Court: His own testimony doesn't indicate that he had any awareness that there was an insolvency.

Mr. Aaronson: I think his testimony is in conflict with the evidence, your Honor. I appreciate it is a matter of testimony, but the schedules show—it was his testimony that the business conditions did not change from the time of the fire until the time the petition was filed, and these schedules which were subscribed and sworn to and filed, were taken from the books which show the condition at that time, and as I indicated to your Honor, it shows of the \$44,000 on the asset side over \$24,000 is not in existence. [26]

The Court: \$24,000 and what?

Mr. Aaronson: Was not in existence, because it includes some 24,000 odd dollars of equipment and supplies and so on that were destroyed in the fire. It also shows the fire insurance, which is actually the only asset, and it shows the \$1,900 in Mr. McDonald's possession, which it is not.

The Court: Of course the assets might have been more than the insurance money if there was a fire.

Mr. Aaronson: The insurance is on an inventory basis to the full extent of the inventory to I think it is 18,000—it covered up to \$18,000, as I re-

member. The fixtures and equipment not covered by the insurance, except for a few minor items, were all covered by contracts of sales as shown in the schedule, on which there were balances owing.

The Court: What was the liability with respect to those contracts in the event of fire?

Mr. Aaronson: As far as I know, there were no loss payees on those contracts. They might have been covered by their own policies. There have been no proceedings brought to the attention of the trustee that anybody claims the money; in fact, the policies do not show it. We received the money from the insurance company. So I would say if they are not covered by their own insurance, they would be unsecured in these proceedings. Even allowing and saying that they [27] actually contributed to the business \$24,000 plus the fire insurance, which is also shown in the schedules, which still have almost two to one liabilities over the assets—a condition which did not change at any time from prior to the time he took the money to the time of the bankruptcy.

The Court: That may be so, but the testimony was he didn't take that point of view until later on when he agreed to join in the petition for insolvency as the only thing left to be done. Theoretically, you can argue as you have——

Mr. Aaronson: That's it.

The Court: ——that since he testified that the assets were the same and the liabilities were the same on the date the bankruptcy petition was filed as they were on the day that he received the money,

that, theoretically, the argument is that he must have been aware of that condition.

Mr. Aaronson: As the president of the concern.

The Court: His testimony is, however—and it is uncontroverted—that he didn't want to go into bankruptcy at the time; that he was opposed to it, and that finally he did.

Mr. Aaronson: Yes.

The Court: I mean, that is his testimony.

Mr. Aaronson: His testimony was that they thought——

The Court: The bankruptcy petition was not filed until the 16th or 17th, I think.

Mr. Aaronson: It actually wasn't filed until the 30th. [28] The resolution was adopted on the 15th.

The Court: Yes.

Mr. Aaronson I also know why it was adopted, but I think that is a matter that is not involved here. It was his testimony, your Honor, that they were going to try to work it out and have a fire sale. That was his testimony. It is uncontroverted because I wasn't present at any of the meetings—they were going to attempt to continue and have a fire sale and work it out with the creditors and continue. Of course it was our contention that what the intentions of the parties are, the good or bad intentions of the parties, is not an element to be considered. It is purely a question of Whether or not the bankruptcy act was violated——

The Court: It is a question of whether or not there was knowledge——

Mr. Aaronson: ——and it is our contention that

it was, because he was president and general manager and he well knew the condition of the business.

The Court: I take it the matter will be submitted. You have no further evidence?

Mr. Aaronson: I have nothing further.

The Court: You have testified in the case.

I would like to look at the schedules a little more carefully, so I will mark the matter submitted.

Mr. Aaronson: Very well. Thank you.

[Endorsed]: Filed October 3, 1956. [29]

[Title of District Court and Cause.]

CLERK'S CERTIFICATE

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein as designated by the attorneys for the appellant:

Excerpt from Docket Entries.

Complaint.

Answer of Defendant.

Order for Judgment.

Findings of Fact and Conclusions of Law.

Judgment.

Notice of Appeal.

Designation of Record on Appeal.

Reporter's Transcript of Proceedings, August 2, 1956.

Plaintiff's Exhibits 1 and 2.

In Witness Whereof, I have hereunto set my hand and affixed the seal of said District Court this 8th day of October, 1956.

C. W. CALBREATH,
Clerk,

By /s/ MARGARET P. BLAIR,
Deputy.

[Title of District Court and Cause.]

EXCERPT FROM DOCKET ENTRIES

1956

May 17—Filed complaint—issued summons.

June 23—Filed answer of defendant.

July 2—Ordered for trial August 2, 1956.

Aug. 2—Court trial. Evidence and exhibits introduced, arguments heard and case submitted.

Aug. 3—Filed order for judgment for defendant. Counsel to present findings, conclusions and a form of judgment.

Aug. 27—Filed findings of fact and conclusions of law.

Aug. 27—Entered judgment—filed Aug. 27, 1956—for defendant, and for costs.

Aug. 29—Filed notice of appeal by plaintiff.

Aug. 29—Filed appellant's designation of record on appeal.

Oct. 3—Filed reporter's transcript of proceedings
Aug. 2, 1956.

[Endorsed]: No. 15326. United States Court of Appeals for the Ninth Circuit. Ralph E. Williams as Trustee of the Estate of Future Mfg. Cooperative, Inc., Bankrupt, Appellant, vs. Leamon T. McDonald, Appellee. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed October 8, 1956.

Docketed October 15, 1956.

/s/ PAUL P. O'BRIEN,
Clerk of the United States Court of Appeals for
the Ninth Circuit.

United States Court of Appeals
for the Ninth Circuit

No. 15326

RALPH E. WILLIAMS, as Trustee of the Estate
of FUTURE MFG. COOPERATIVE, INC.,
Bankrupt,

Appellant,

vs.

LEAMON T. McDONALD,

Appellee.

APPELLANT'S CONCISE STATEMENTS OF
POINTS TO BE URGED ON APPEAL

Comes now Ralph E. Williams, Appellant herein, and in accordance with Rule 17(6) of the Rules and Practice of the United States Court of Appeals for the Ninth Circuit specifies the following as a concise statement of the points on which he intends to rely on this appeal from the Judgment made and entered by Hon. Louis E. Goodman, Judge of the United States District Court for the Northern District of California, on August 27, 1956, and more particularly specified and described in Notice of Appeal heretofore filed with the Clerk of said District Court on August 29, 1956, as follows:

That the conclusions of law No. 1 and 2 are not supported by the evidence and are contrary to the law in that

I.

That the District Court in said Judgment erred in finding that the Defendant did not have knowl-

edge, or reasonable cause to believe, that the bankrupt was insolvent at the time of the payment.

II.

That the District Court in said Judgment erred in holding that Plaintiff could not recover from Defendant the alleged preferential payment.

Dated: October 11, 1956.

Respectfully submitted,

SHAPRO & ROTHSCCHILD and
JAMES M. CONNERS,

By /s/ DANIEL ARONSON, JR.,
Attorneys for Appellant, Ralph E. Williams, as
Trustee of the Estate of Future Mfg. Cooperative, Inc., Bankrupt.

[Endorsed]: Filed October 12, 1956.

No. 15,326

United States Court of Appeals
For the Ninth Circuit

RALPH E. WILLIAMS, as Trustee of the
Estate of Future Mfg. Cooperative,
Inc., Bankrupt,

Appellant,

vs.

LEAMON T. McDONALD,

Appellee.

APPELLANT'S OPENING BRIEF.

SHAPRO & ROTHSCHILD,

155 Montgomery Street, San Francisco 4, California,

JAMES M. CONNERS,

989 Market Street, San Francisco 3, California,

Attorneys for Appellant

Ralph E. Williams.

DANIEL ARONSON, JR.,

155 Montgomery Street, San Francisco 4, California,

Of Counsel.

FILED

JAN 28 1957

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No. 15,326

**United States Court of Appeals
For the Ninth Circuit**

RALPH E. WILLIAMS, as Trustee of the
Estate of Future Mfg. Cooperative,
Inc., Bankrupt,

Appellant,

vs.

LEAMON T. McDONALD,

Appellee.

APPELLANT'S OPENING BRIEF.

STATEMENT OF JURISDICTION.

Appellant filed a complaint in the United States District Court for the Northern District of California, Southern Division (T.R., p. 3) to recover a preference from Appellee pursuant to the provisions of Section 60 (a)-(b) of the Bankruptcy Act (11 U.S.C.A. 96(a)-(b)). On August 27, 1956, the District Court rendered its judgment in favor of Appellee (T.R., p. 9). Notice of appeal therefrom was filed August 29, 1956 (T.R., p. 10). The appeal was timely filed (11 U.S.C.A. 48).

STATEMENT OF THE QUESTION PRESENTED.

The question before the Court is whether or not Appellee, president, general manager and operator of the bankrupt corporation, had reasonable cause to believe that the bankrupt corporation was insolvent at the time that he paid himself (from the bankrupt's funds) the past due salary within thirty days prior to the filing of the voluntary petition in bankruptcy, so that such payment would constitute a preference within the meaning of the Bankruptcy Act.

STATEMENT OF FACTS.

On January 30, 1956, a voluntary petition in bankruptcy was filed by Future Mfg. Cooperative, Inc., in the United States District Court for the Northern District of California, Southern Division, in proceeding therein numbered 46033 and thereafter Future Mfg. Cooperative, Inc., was duly adjudged a bankrupt. During the night of January 2, 1956, the business operated by the bankrupt corporation was destroyed by fire (T.R., p. 13). On January 4, 1956, Appellee received the receipts for the operation of the business for the week prior to the fire, and he paid to himself the sum of \$1,776.00 for back wages (T.R., pp. 13 and 14). At the time of this payment Appellee was the president, general manager and operator of the business (T.R., p. 13).

ARGUMENT.

- I. THE DISTRICT COURT ERRED IN FINDING THAT APPELLEE DID NOT HAVE KNOWLEDGE OR REASONABLE CAUSE TO BELIEVE THAT THE BANKRUPT CORPORATION WAS INSOLVENT AND IN CONCLUDING THEREFROM THAT THE PAYMENT OF \$1,776.00 TAKEN BY APPELLEE WITHIN FOUR MONTHS OF THE FILING OF THE PETITION IN BANKRUPTCY ON ACCOUNT OF HIS PAST DUE WAGES WAS NOT PREFERENTIAL.

The Court made the following finding of fact (T.R., p. 7):

“(II) That each and all of the allegations contained in paragraph III of said Plaintiff’s Complaint are true, saving and excepting the words ‘Defendant well knew and/or had reasonable cause to believe that said transferor was insolvent,’ and that said exception is untrue.”

and concluded therefrom (T.R., pp. 7 and 8):

“(I) That the payment by the Bankrupt to the Defendant of the sum of \$1,776.00 within four months next preceding the filing of the petition in bankruptcy by said Bankrupt on the 30th day of January, 1956, was not a voidable preference under Section 60(b) of the Bankruptcy Act, and that said Defendant did not have knowledge or reasonable cause to believe that said Bankrupt was insolvent at the time of said payment.

(II) That Plaintiff is not entitled to recover the said sum of \$1,776.00 from Defendant.”

The finding and the conclusions herein above quoted raise the sole question of this appeal. It is Appellant’s contention that the finding is erroneous as a matter of law and that, therefore, the conclusion must fall.

The District Court found that, among other things, the bankrupt corporation was insolvent at the time of the payment of the past due salary by Appellee to himself (T.R., p. 7), in that the Court found the allegation "while then and there insolvent" contained in paragraph III of Appellant's Complaint (T.R., p. 4), to be true. The finding of insolvency is well supported by the evidence and testimony presented in the trial of the issue (T.R., pp. 14 and 15; T.R., pp. 21 and 22; and T.R., p. 29) (Plaintiff's Exhibit No. 1). Therefore the sole issue present is the question of the reasonable cause of Appellee to believe the bankrupt was insolvent.

- (1) Appellee had reasonable cause to believe the bankrupt to be insolvent at the time he took the preferential payment.**

A preference within the meaning of the Bankruptcy Act and the Trustee's right to avoid a preference is established by Section 60(a)-(b) of the Bankruptcy Act (11 U.S.C.A. 96(a)-(b)), which read, in part, as follows:

Section 60a(1)

"A preference is a transfer, as defined in this Act, of any of the property of a debtor to or for the benefit of a creditor for or on account of an antecedent debt, made or suffered by such debtor while insolvent and within four months before the filing by or against him of the petition initiating a proceeding under this Act, the effect of which transfer will be to enable such creditor to obtain a greater percentage of his debt than some other creditor of the same class."

Section 60b

“Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor’s transferee for a present fair equivalent value . . .”

Some Courts, apparently including the District Court here¹ have erroneously required “actual knowl-

¹“The Court. Mr. Aaronson, there is no evidence that would justify that this money was taken with knowledge of bankruptcy.

Mr. Aaronson. Insolvency, not bankruptcy. The witness testified that there was no operation subsequent to the fire and that the assets and liabilities of the corporation were exactly the same at the time of the fire, which was before the taking of the money, as they were at the time of the filing of the petition. The schedules show almost two to one on the liability side.

And I might further add that an examination of the B side of the schedules, the assets, will show \$24,000 set up as property—personal property and equipment—of which there was none, other than a few items, which incidentally are listed as amounts unknown, which were not on the premises destroyed by the fire, and also include the \$1,900 that Mr. McDonald got. So if you reduce that, you have 80 odd thousand dollars, less—

The Court. On the figures, yes, but the witness has testified that they thereafter were intending to continue with the business, which would not indicate an insolvency. You put him on. That is his testimony.

Mr. Aaronson. I appreciate that, your Honor; but the question of insolvency is the excess of the liabilities over the assets.

The Court. That is true, but in recovering a preference the burden is to show—

Mr. Aaronson. Reasonable cause to believe they were solvent.

The Court. —reasonable cause to believe that the concern was insolvent.

Mr. Aaronson. Mr. McDonald testified only that they were going to try to continue on, and he was president and operated the

The District Court found that, among other things, the bankrupt corporation was insolvent at the time of the payment of the past due salary by Appellee to himself (T.R., p. 7), in that the Court found the allegation "while then and there insolvent" contained in paragraph III of Appellant's Complaint (T.R., p. 4), to be true. The finding of insolvency is well supported by the evidence and testimony presented in the trial of the issue (T.R., pp. 14 and 15; T.R., pp. 21 and 22; and T.R., p. 29) (Plaintiff's Exhibit No. 1). Therefore the sole issue present is the question of the reasonable cause of Appellee to believe the bankrupt was insolvent.

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“Any such preference may be avoided by the trustee if the creditor receiving it or to be benefited thereby or his agent acting with reference thereto has, at the time when the transfer is made, reasonable cause to believe that the debtor is insolvent. Where the preference is voidable, the trustee may recover the property or, if it has been converted, its value from any person who has received or converted such property, except a bona-fide purchaser from or lienor of the debtor’s transferee for a present fair equivalent value . . .”

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The Court. That is true, but in recovering a preference the burden is to show—

Mr. Aaronson. Reasonable cause to believe they were solvent.

The Court. —reasonable cause to believe that the concern was involvent.

Mr. Aaronson. Mr. McDonald testified only that they were going to try to continue on, and he was president and operated the

edge" of insolvency rather than "reasonable cause to believe that the debtor is insolvent" and have confused "insolvency" with "bankruptcy" notwithstanding the

business, and he well knew the condition of the business, and that there was no operation, so that the business, as the records show in the schedules, was in exactly the same condition at the time the petition was filed as it was at the time he took the money.

The Court. The only circumstance is that this \$1,700 was paid after the fire when the business was inoperative. That is the only circumstance.

Mr. Aaronson. I might say——

The Court. I have grave doubts as to whether or not there would be a preponderance of evidence that would be sufficient to warrant a finding that that was a preferential payment under the statute. There is a slimness of any evidence except the circumstance that here was a business that was apparently going along then there was a fire, and then it was closed down for a time, and this man says he needed the money because he had been devoting himself to operating this business, so he took the back salary at that time. I have doubts as to whether or not that circumstance is sufficient to warrant the inference that he took the money at that time with the awareness that the business was insolvent and that the effect of what he was doing was getting a preference over somebody else."

(T.R., pp. 28, 29 and 30.)

"The Court. There is a very slim record here, Mr. Aaronson and it doesn't seem to me to be sufficient to warrant adjudging a repayment of this as a preference. The only circumstance is that after the fire and before anything further was done, then he received the past due wages that were due him. That is all that the record shows.

Now we would have to indulge in the assumption at that time that that payment was made that the concern was insolvent; that he knew it was insolvent; that he took this money and got this money knowing that he was being preferred to other creditors at the time." (Emphasis added.)

"Mr. Aaronson. I think that is what the record shows, your Honor, exactly.

The Court. His own testimony doesn't indicate that he had any awareness that there was an insolvency.

Mr. Aaronson. I think his testimony is in conflict with the evidence, your Honor. I appreciate it is a matter of testimony but the schedules show—it was his testimony that the business conditions did not change from the time of the fire until the time the petition was filed, and these schedules which were subscribed and sworn to and filed, were taken from the books which

language of Section 60 of the Bankruptcy Act herein-above set forth. See 3 *Collier on Bankruptcy* 14th Ed., Section 60.53, p. 989:

show the condition at that time, and as I indicated to your Honor, it shows of the \$44,000 on the asset side over \$24,000 is not in existence.

The Court. \$24,000 and what?

Mr. Aaronson. Was not in existence, because it includes some 24,000 odd dollars of equipment and supplies and so on that were destroyed in the fire. It also shows the fire insurance, which is actually the only asset, and it shows the \$1,900 in Mr. McDonald's possession, which it is not."

(T.R., pp. 32 and 33.)

"The Court. —that since he testified that the assets were the same and the liabilities were the same on the date the bankruptcy petition was filed as they were on the day that he received the money, that, theoretically, the argument is that he must have been aware of that condition.

Mr. Aaronson. As the president of the concern.

The Court. His testimony is, however—and it is uncontroverted—that he didn't want to go into bankruptcy at the time; that he was opposed to it, and that finally he did.

Mr. Aaronson. Yes.

The Court. I mean, that is his testimony.

Mr. Aaronson. His testimony was that they thought—

The Court. The bankruptcy petition was not filed until the 16th or 17th, I think.

Mr. Aaronson. It actually wasn't filed until the 30th. The resolution was adopted on the 15th.

The Court. Yes.

Mr. Aaronson. I also know why it was adopted, but I think that is a matter that is not involved here. It was his testimony, your Honor, that they were going to try to work it out and have a fire sale. That was his testimony. It is uncontroverted because I wasn't present at any of the meetings—they were going to attempt to continue and have a fire sale and work it out with the creditors and continue. Of course it was our contention that what the intentions of the parties are, the good or bad intentions of the parties, is not an element to be considered. It is purely a question of whether or not the bankruptcy act was violated—

The Court. It is a question of whether or not there was knowledge—

Mr. Aaronson. —and it is our contention that it was, because he was president and general manager and he well knew the condition of the business."

(T.R., pp. 34, 35 and 36.)

“Knowledge of insolvency is not necessary, nor even actual belief thereof; all that is required is a reasonable cause to believe that the debtor was insolvent at the time of the preferential transfer. *A creditor has reasonable cause to believe that a debtor is insolvent when such a state of facts is brought to the creditor’s notice respecting the affairs and pecuniary condition of a debtor, as would lead a prudent business person to the conclusion that the debtor is insolvent.*” (Italics ours.)

Thus, if the facts are sufficient to put a prudent business person on notice, he is chargeable with notice of all the facts which reasonably diligent inquiry would have disclosed.

Here, the Appellee was the president, general manager and operator of the bankrupt corporation which was a small grocery store and was in a far better position than any other creditor to know the financial condition of the corporation. When Appellee took the preferential payment, he was well aware of the fact that the business had been destroyed by fire, and that there were other creditors in existence and that no payments were made to them. Appellant cannot conceive that the Appellee, president, general manager and operator of the business, did not know about the company’s insolvency. In any event, such an officer is *presumed* to have such knowledge.

Matter of W. A. Silvernail Co., 218 Fed. 978,
33 Am. Br. 59;

Irving Trust Co. v. Roth, D.C., N.Y., 48 F. 2d
345;

Cohen v. Tremont Trust Co. (D.C. Mass.), 256 Fed. 399, aff'd 263 F. 81;

New York Credit Men's Ass'n v. Hasenberg (D.C., N.Y.), 26 F. Supp. 877, aff'd 107 F. 2d 1020;

In re Plant, 148 Fed. 37.

It appears apparent that the District Court must have used its own interpretation concerning proof of insolvency and reasonable knowledge thereof on behalf of Appellee with the result that the Court reached a decision which in effect permits an officer of a corporation on whom creditors must rely on their business dealings to take advantage of his position and knowledge to fill his own pocket at the creditors' expense.

CONCLUSION.

In view of the law and the facts as hereinabove set forth, it is Appellant's contention that the finding and conclusions of the trial Court (T.R., pp. 7 and 8) are unsupported by the evidence and are contrary to law. We feel that the purpose of the preference law is to prevent a depletion of the insolvent debtor's estate by transfers to any creditors who have either knowledge of or reasonable cause to believe in the debtor's insolvency at the time of receipt of such payments. We believe that such recoveries should be had, regardless of the amount involved, and that *to condone the trial Court's judgment in this case would be to encourage, rather than discourage, corporate officers, with knowl-*

edge of a failing business, to withdraw as much of the corporation's cash prior to bankruptcy as their back salaries or other personal claims as creditors could possibly permit. This is not consistent with the right of creditors generally which the Bankruptcy Act is designed to protect. For these reasons we believe the trustee in bankruptcy must bring actions such as this even though the amounts involved may individually be small, because when added together, they would substantially increase the fund to which general creditors could look for recovery on their claims.

It is, therefore, respectfully submitted that the judgment of the District Court of August 2, 1956, should be reversed.

Dated, San Francisco, California,
January 25, 1957.

Respectfully submitted,

SHAPRO & ROTHSCHILD,

JAMES M. CONNERS,

By ARTHUR P. SHAPRO,

Attorneys for Appellant

Ralph E. Williams.

DANIEL ARONSON, JR.,
Of Counsel.

No. 15335

United States
Court of Appeals
for the Ninth Circuit

CANADIAN INDEMNITY COMPANY, a Corporation,

Appellant,

VS.

OHIO FARMERS' INDEMNITY COMPANY and
PRUDENTIAL ASSURANCE COMPANY
OF LONDON,

Appellees.

Transcript of Record

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

FILED

JAN 18 1957

PAUL P. O'BRIEN, CLERK

No. 15335

United States
Court of Appeals
for the Ninth Circuit

CANADIAN INDEMNITY COMPANY, a Corporation,

Appellant,

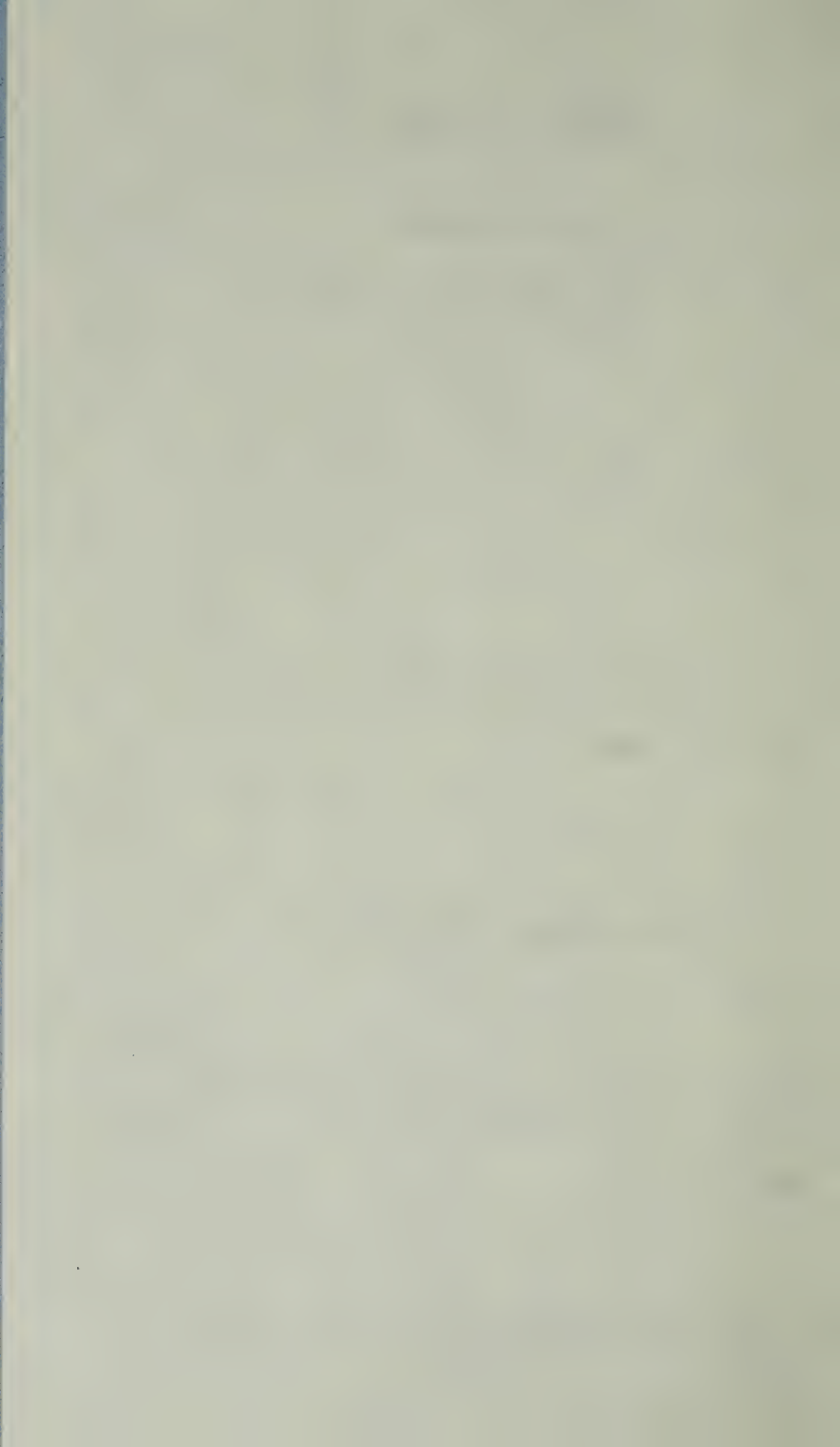
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Appeal from the United States District Court for the
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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LLOYD M. TWEEDT,
JAMES A. QUINBY,
STANLEY J. COOK,
DERBY, COOK, QUINBY & TWEEDT,
1000 Merchants Exchange Building,
San Francisco, Calif.,
For Appellee Prudential Assurance Com-
pany of London, sued herein as John
Doe.

In the United States District Court for the Northern
District of California, Southern Division
Civil No. 34158

THE CANADIAN INDEMNITY COMPANY, a
Corporation, Plaintiff,

vs.

OHIO FARMERS INSURANCE COMPANY, a
Corporation, Defendant.

ANSWERS TO INTERROGATORIES PRO-
POUNDED BY PLAINTIFF TO DEFEND-
ANT

* * *

[Insurance Policy of Ohio Farmers
Insurance Company]

* * *

Ohio Farmers Indemnity Company, LeRoy, Ohio,
a Stock Insurance Company, Herein Called the
Company

Agrees with the Insured, named in the Declara-
tions made a part hereof, in consideration of the
payment of the premium and in reliance upon the
statements in the Declarations and subject to the
limits of liability, exclusions, conditions and other
terms of this policy.

Insuring Agreements

1. Coverage A—Bodily Injury Liability—Auto-
mobile

* * *

Coverage B—Bodily Injury Liability—Except
Automobile

To pay on behalf of the Insured all sums
which the Insured shall become legally obligated
to pay as damages because of bodily injury,

sickness or disease, including death at any time resulting therefrom, sustained by any person and caused by accident.

* * *

11. Defense, Settlement, Supplementary Payment

As respects the insurance afforded by the other terms of this policy the Company shall

(a) defend any suit against the Insured alleging such injury, sickness, disease or destruction and seeking damages on account thereof even if such suit is groundless, false or fraudulent, but the Company may make such investigation, negotiation and settlement of any claim or suit as it deems expedient;

* * *

(c) pay all expenses incurred by the Company, all costs taxed against the Insured in any such suit and all interest accruing after entry of judgment until the Company has paid or tendered or deposited in court such part of such judgment as does not exceed the limit of the Company's liability thereon;

* * *

(e) reimburse the Insured for all reasonable expenses, other than loss of earnings, incurred at the Company's request.

The amounts incurred under this insurance agreement, except settlements of claims and suits, are payable by the Company in addition to the applicable limit of liability of this policy

* * *

[Endorsed]: Filed December 15, 1954.

In the District Court of the United States, North-
ern District of California, Southern Division

Civil No. 34158

THE CANADIAN INDEMNITY COMPANY,
a corporation, Plaintiff,

vs.

OHIO FARMERS INDEMNITY COMPANY,
a corporation, JOHN DOE and all other un-
derwriters at Lloyd's London subscribing to
Lloyd's Policy No. EB32914-C; RICHARD
ROE and all other underwriters at Lloyd's
London subscribing to Lloyd's Policy No.
EB32913-L, Defendants.

FIRST AMENDED COMPLAINT IN
DECLARATORY RELIEF

Plaintiff complains of defendants and for cause
of action alleges:

I.

That the plaintiff is a Canadian corporation; that
the defendant Ohio Farmers Indemnity Company is
an Ohio corporation; that all of the remaining de-
fendants are subjects of Great Britain and/or Brit-
ish business associations; that the amount in con-
troversy exceeds \$3000.00.

II.

That on the 17th day of September, 1954, plain-
tiff had in force its liability policy number 25 CPL

1911 covering the liability of that certain Louis Store located at 3925 MacArthur Boulevard, Oakland, California, to parties injured on the premises of said store to the extent of \$100,000.00; that said contract of insurance is by its terms excess to all other insurance available to the insured.

III.

That plaintiff is informed and believes and therefore alleges that on the date aforementioned the defendants had policies of liability insurance in full force and effect covering the liability of Louis Stores Inc. toward all parties injured on the premises of such Louis Stores, or injured by reason of negligence imputable to Louis Stores Inc.

IV.

That on the 17th day of September, 1954, one Virginia Christensen was seriously injured on the premises of that certain Louis Store located at 3925 MacArthur Boulevard, Oakland, California, allegedly as the result of the negligence of an employee or employees of Louis Stores Inc.

V.

That by reason of the facts herein alleged a dispute exists between the plaintiff and the defendants concerning their respective obligations to investigate, defend against, or pay any liability that may be assessed against Louis Stores Inc. and its employees as a result of the injuries sustained by Virginia Christensen.

Wherefore plaintiff prays for a decree of this court declaring the respective rights and liabilities of the plaintiff and the defendants.

/s/ EDWARD A. FRIEND,
Attorney for Plaintiff

[Endorsed]: Filed Jan. 5, 1955.

[Title of District Court and Cause.]

ANSWER TO FIRST AMENDED COMPLAINT

Comes now the defendant Ohio Farmers Indemnity Company, a corporation, and answers the first amended complaint of plaintiff on file herein, and by way of defense thereto, admits, denies and alleges:

I.

Admits the allegations set forth in Paragraph II of said first amended complaint, save and except, expressly denies that the said contract of insurance is, by its terms, excess to all other insurance available to the insured, and that it is, in fact, concurrent, contributing and pro-rata insurance.

II.

Answering the allegations of Paragraph V of said first amended complaint, this answering defendant denies that there is any dispute concerning the respective obligations of the parties on its part. That at all times mentioned herein, Ohio Farmers Indemnity Company, a corporation, has had a policy with a limit of \$10,000.00 for bodily injury cov-

erage other than products liability or automobile liability. That by the "escape clause" appearing in the policy issued by plaintiff to Louis Stores, Inc., there appears the following insofar as the claimant Virginia Christensen is concerned:

"Other Insurance. If at the time of an accident there is any other insurance available to the insured (in this or any other carrier) there shall be no insurance afforded hereunder as respects such accident except that if the applicable limit of liability of this policy is in excess of the applicable limit provided by the other insurance available to the insured this policy shall afford excess insurance over and above such other insurance in an amount sufficient to afford the insured a combined limit of liability equal to the applicable limit of liability afforded by this policy."

That under the policy issued by this answering defendant the "escape clause" reads:

"Other Insurance. If the insured has other insurance against a loss covered by this policy the Company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the Declaration bears to the total applicable limit of liability of all valid and collectible insurance against such loss;"

That the two "escape clauses" are mutually repugnant and therefore the obligation of the plaintiff and defendant for the investigation, defense, costs and payments for the claim of Virginia Christensen, if established to be due under said policies, should be pro-rated in proportion to the respective

limits of liability; that this answering defendant is ready to assume its pro-rated obligations under the terms of the respective policies.

Wherefore, this answering defendant prays that plaintiff take nothing by its complaint and that the same be dismissed herefrom.

HEALY AND WALCOM,
/s/ LEO J. WALCOM,
Attorneys for Defendant

[Endorsed]: Filed Jan. 25, 1955.

[Title of District Court and Cause.]

ANSWER TO AMENDED COMPLAINT

Defendant The Prudential Assurance Company Limited of London, a corporation, the underwriter subscribing to policy number EB 32914-C, sued herein as John Doe, and all other underwriters at Lloyd's London subscribing to Lloyd's policy No. EB 32914-C, answers the amended complaint herein as follows:

I.

The amended complaint fails to state a claim against said defendant upon which relief can be granted.

II.

Answering paragraph I of said amended complaint, said defendant alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraph, except said defendant admits that it is

a corporation organized and existing under the laws of the United Kingdom of Great Britain and Ireland.

III.

Answering paragraph II of said amended complaint, as amended by more Definite Statement herein, said defendant alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraph.

IV.

Answering paragraph III of said amended complaint, said defendant as to itself denies each and every allegation contained in said paragraph. In this respect, said defendant alleges that on or about the 1st day of September, 1954, it issued to Louis Stores, Inc. a certificate of excess public liability insurance No. EB 32914-C. A copy of said certificate of insurance is annexed hereto, marked Exhibit A, and is expressly incorporated in and made a part of this answer.

V.

Answering paragraph IV of said amended complaint, said defendant alleges that it is without knowledge or information sufficient to form a belief as to the truth of the allegations contained in said paragraph.

VI.

Answering paragraph V of said amended complaint, said defendant as to itself denies each and every allegation contained in said paragraph. In this respect, said defendant alleges that it has no

privity of contract with plaintiff by reason of any of the matters alleged in said amended complaint; that no demand has been made upon said defendant by the assured under the policy of insurance referred to in said amended complaint; that no demand has been made by anyone else upon said defendant by reason of the matters set forth in said amended complaint; that there is and can be no justifiable controversy between plaintiff and said defendant by reason of any of the matters set forth in said amended complaint.

VII.

A determination of the matters set forth in said amended complaint would serve no useful purpose in that such determination would not be a final and binding determination of the rights and liabilities of all parties to said alleged contracts of insurance or of all parties to said action brought by said Virginia Christensen.

Wherefore, said defendant prays that the amended complaint herein be dismissed without relief to plaintiff and that defendant recover its costs herein.

DERBY, COOK, QUINBY &
TWEEDT,

/s/ By LLOYD M. TWEEDT,

Attorneys for said Defendant

Acknowledgment of Service Attached.

EXHIBIT A

CERTIFICATE OF INSURANCE

No. EB 32914-C. Issued by Swett & Crawford.

Assured: Louis Stores, Inc. Expiration: September 1, 1957.

In accordance with authorization granted to Swett & Crawford by certain Companies in England whose names and the proportions underwritten by them are or will be on file in the office of said Swett & Crawford and also on file in the office of Sedgwick, Collins & Co., Limited, of London, England (such Companies being hereinafter called the Underwriters.

Pursuant to such authorization the Underwriters do hereby bind themselves, each for his own part and not one for another, in favor of Louis Stores, Inc., Assured. Address: 3201 Shattuck Avenue, Berkeley 5, California. Type of coverage: First Excess Comprehensive Public Liability Insurance; in the amount of Forty/Thirty/Thirty Thousand Dollars the Excess of Ten/Twenty/Twenty Thousand Dollars Bodily Injury.

Beginning at 12:01 A. M. on the 1st day of September, 1954 and ending at 12:01 A. M. on the 1st day of September, 1957, standard time at the place of location of risks insured, and in accordance with the terms and conditions of the form(s) attached.

Amount: \$40/30/30,000.00; Rate XS; Amount: 10/20/20,000.00; Rate BI; Premium \$7,920.00; 4% Federal Tax \$316.80, 3% State Tax \$237.60, 1/2% Stamping Fee \$39.60, Total \$8,514.00.

1. It is expressly understood and agreed by the Assured by accepting this instrument that Swett & Crawford is not one of the Underwriters or Assurers hereunder and neither is nor shall be in any way or to any extent liable for any loss or claim whatever, as an Assurer, but the Assurers hereunder are only those Companies in England whose names are on file as hereinbefore set forth.

2. If the Assured shall make any claim knowing the same to be false or fraudulent, as regards amount or otherwise, this Certificate shall become void and all claims hereunder shall be forfeited.

3. This Certificate may be cancelled on the customary short rate basis by the Assured at any time by written notice or by surrender of this Certificate to Swett & Crawford. This Certificate may also be cancelled, with or without the return or tender of the unearned premium, by Underwriters, or by Swett & Crawford in their behalf by delivering to the Assured or by sending to the Assured by mail, registered or unregistered, at the Assured's address as shown herein, not less than 10 days' written notice stating when the cancellation shall be effective, and in such case Underwriters shall refund the paid premium less the earned portion thereof on demand, subject always to the retention by Underwriters hereon of any minimum premium stipulated herein (or proportion thereof previously agreed upon) in the event of cancellation either by Underwriters or Assured.

4. This Certificate of insurance shall not be assigned either in whole or part, without the written

consent of Swett & Crawford endorsed hereon.

5. Loss or damage to the property insured occasioned by war, invasion, hostilities, acts of foreign enemies, civil war, rebellion, insurrection, military or usurped power or martial law or confiscation by order of any Government or public authority not covered.

6. This insurance is made and accepted subject to all the provisions, conditions and warranties set forth herein and in any forms or endorsements attached hereto, all of which are to be considered as incorporated herein, and any provisions or conditions appearing in any forms or endorsements attached hereto which alter the Certificate provisions stated above shall supersede such Certificate provisions in so far as they are inconsistent therewith.

7. United States Internal Revenue Documentary Stamps in the amount required and applicable to this insurance have been affixed to the office record of this Certificate retained by Swett & Crawford. The Law provides for no Federal Tax refund once the insurance attaches.

This Certificate shall not be valid unless signed by Swett & Crawford.

Dated at.....this....day of.....

Swett & Crawford,

By

Lloyd's Excess Public Liability Form
(Including Products Liability)
(Direct Insurance)

Underwriters hereby agree, subject to the terms,

conditions and limitations hereinafter mentioned, to indemnify the Assured in respect of accidents occurring during the period stated herein for any and all sums which the Assured shall by law become liable to pay and shall pay or by final judgment be adjudged to pay to any person or persons (excepting employees of the Assured injured during the course of their employment) as damages for bodily injuries, including death at any time resulting therefrom, caused by accident arising out of the hazards covered by and as defined in the underlying policy/ies specified in the Schedule herein and issued by the Ohio Farmers Indemnity Company, hereinafter called the "Primary Insurers,"

Provided always that it is expressly agreed that liability shall attach to Underwriters only after the Primary Insurers have paid or have been held liable to pay the full amount of their respective ultimate net loss liability as follows:

\$10,000.00 ultimate net loss in respect of each person and, subject to that same limit each person, \$20,000.00 ultimate net loss in respect of each accident but, as regards Products Liability, \$20,000.00 ultimate net loss in the aggregate in any one policy year (hereinafter referred to as the "Primary Limit or Limits"); and Underwriters shall then be liable to pay only such additional amounts as will provide the Assured with a total coverage under the policy/ies of the Primary Insurers and this Certificate combined of \$50,000.00 ultimate net loss in respect of each person and, subject to that same limit each person, \$50,000.00 ultimate net loss in respect of

each accident but, as regards Products Liability, not exceeding \$50,000.00 ultimate net loss in the aggregate in any one policy year.

Schedule

The underlying policy/ies hereinbefore mentioned: Ohio Farmers Indemnity Company Policy Number CL7591 or any renewals thereof.

Conditions

1. Premium Computation (delete clause not applicable).

(a) Deleted.

(b) The premium for this Certificate is computed by applying to the gross premium of the policy/ies of the Primary Insurers a percentage calculated at 100 per cent of the Manual Increase percentage in use by the Bureau Companies for ascertaining the difference in premium between

(I) A policy with limits equal to the limits of the policy/ies of the Primary Insurers and

(II) A policy with limits equal to the limits of this Certificate and of the policy/ies of the Primary Insurers combined,

subject to a minimum premium of \$7,920.00.

Attached to and forming part of Certificate No. EB 32914-C.

Issued to: Louis Stores, Inc. Dated: September 1, 1954.

(Provisions on the back of this form are hereby referred to and made a part hereof.)

SCL 5268 (T.P.7)

Printed in U.S.A.

53-405

2. **Payment of Costs.** "Costs" incurred by the Assured personally, with the written consent of Underwriters, and for which the Assured is not covered by the said Primary Insurers, shall be apportioned as follows:

(a) In the event of claim or claims arising which appear likely to exceed the Primary Limit or Limits, no "Costs" shall be incurred by the Assured without the written consent of Underwriters.

(b) Should such claim or claims become adjustable previous to going into court for not more than the Primary Limit or Limits, then no "Costs" shall be payable by Underwriters.

(c) Should, however, the sum for which the said claim or claims may be so adjustable exceed the Primary Limit or Limits, then Underwriters, if they consent to the proceedings continuing, shall contribute to the "Costs" incurred by the Assured in the ratio that their proportion of the ultimate net loss as finally adjusted bears to the whole amount of such ultimate net loss.

(d) In the event that the Assured elects not to appeal a judgment in excess of the Primary Limit or Limits Underwriters may elect to conduct such appeal at their own cost and expense and shall be liable for the taxable court costs and interest incidental thereto, but in no event shall the total liability of Underwriters exceed their limit or limits of liability as stated above, plus the expenses of such appeal.

3. **Application of Salvage.** All salvages, recoveries or payments recovered or received subsequent

to a loss settlement under this Certificate shall be applied as if recovered or received prior to such settlement and all necessary adjustments shall then be made between the Assured and Underwriters provided always that nothing in this clause shall be construed to mean that losses under this Certificate are not recoverable until the Assured's ultimate net loss has been finally ascertained.

4. Attachment of Liability. Liability under this Certificate shall not attach unless and until the Primary Insurers shall have admitted liability for the Primary Limit or Limits, or unless and until the Assured has by final judgment been adjudged to pay a sum which exceeds such Primary Limit or Limits.

5. Maintenance of Primary Insurance. This Certificate is subject to the same warranties, terms and conditions (except as regards the premium, the obligation to investigate and defend, the amount and limits of liability and the renewal agreement, if any, and except as otherwise provided herein) as are contained in or as may be added to the policy/ies of the Primary Insurers prior to the happening of an accident for which claim is made hereunder and should any alteration be made in the premium for the policy/ies of the Primary Insurers during the currency of this Certificate, then the premium hereon shall be adjusted accordingly.

It is a condition of this Certificate that the policy/ies of the Primary Insurers shall be maintained in full effect during the currency of this Certificate except for any reduction of the aggregate

limit contained therein solely by payment of claims in respect of accidents occurring during the policy year.

6. Cancellation. This Certificate may be cancelled at any time at the written request of the Assured or may be cancelled by or on behalf of Underwriters provided ten days' notice in writing be given. If this Certificate shall be cancelled by the Assured, Underwriters shall retain the earned premium hereon for the period that this Certificate has been in force or the short-rate proportion of the minimum premium whichever is the greater. If this Certificate shall be cancelled by Underwriters, they shall retain the earned premium hereon for the period that this Certificate has been in force or pro rata of the minimum premium whichever is the greater. Notice of cancellation by Underwriters shall be effective even though Underwriters make no payment or tender of return premium.

7. Notification of Claims. The Assured upon knowledge of any accident or occurrence likely to give rise to a claim hereunder shall give immediate written advice thereof to Swett & Crawford.

8. Fraudulent Claims. If the Assured shall make any claim knowing the same to be false or fraudulent, as regards amount or otherwise, this Certificate shall become void and all claim hereunder shall be forfeited.

Definitions

1. Accident. The word "accident" shall be understood to mean an accident or series of accidents arising out of one event or occurrence.

2. Ultimate Net Loss. The words "ultimate net loss" shall be understood to mean the sums paid in settlement of losses for which the Assured is liable after making deductions for all recoveries, salvages and other insurances (other than recoveries under the policy/ies of the Primary Insurers), whether recoverable or not, and shall exclude all expenses and "Costs."

3. Costs. The word "Costs" shall be understood to mean interest on judgments, investigation, adjustment and legal expenses (excluding, however, all expenses for salaried employees and retained counsel of and all office expenses of the Assured).

4. Policy Year. The words "policy year" shall be understood to mean a period of one calendar year commencing each year on the day and hour first named above.

Endorsement Number 1.

In consideration of the premium charged hereunder it is understood and agreed that:

(1) The words "caused by accident" shall be deemed to be deleted from the insuring clause of this certificate.

(2) The words "accident" or "accidents" wherever appearing in this certificate shall be deemed to read "occurrence" or "occurrences" respectively.

(3) Definition No. 1 (accident) shall be deemed to be deleted and replaced by the following:

1. Occurrence. The word "occurrence" shall be understood to mean an occurrence or series of occurrences arising out of one event.

All other terms and conditions remaining unchanged.

This slip is attached to and made a part of Certificate No. EB32914-C.

Issued to: Louis Stores, Inc. Effective: September 1, 1954.

End. No. 2.

Premium \$ Nil

Total \$ Nil

Kind: First Excess Comprehensive Public Liability Insurance.

Term: September 1, 1954 to September 1, 1957.

In consideration of the premium charged, it is hereby understood and agreed, that Paragraph 2 of Form SCL 5268 attached hereon, is amended to read as follows:

Provided always that it is expressly agreed that liability shall attach to underwriters only after the primary insurers have paid or have been held liable to pay the full amount of their respective ultimate net loss liability as follows:

\$10,000.00 ultimate net loss in respect of each person and, subject to that same limit each person \$20,000.00 ultimate net loss in respect of each accident but, as regards products liability, \$25,000.00 ultimate net loss in the aggregate in any one policy year (hereinafter referred to as the "Primary Limit or Limits"): and underwriters shall then be liable to pay only such additional amounts as will provide the assured with a total coverage under the policy/ies of the primary insurers and this certificate combined of

\$50,000.00 ultimate net loss in respect of each person and, subject to that same limit each person, \$50,000.00 ultimate net loss in respect of each accident but, as regards products liability, not exceeding \$50,000.00 ultimate net loss in the aggregate in any one policy year.

United States Internal Revenue Documentary Stamps in the amount shown above, applicable to this insurance have been affixed to the Accounts copy of this endorsement. The law provides for no Federal Tax refund once the Insurance attaches.

The effective date of this endorsement is September 1, 1954.

All other terms and conditions remain unchanged.

This endorsement is attached to and made a part of Certificate No. EB 32914-C.

Issued to: Louis Stores, Inc. Broker: Charles Epstein Company. Date of issue: 11/4/54. By: rf.

Contract 54/2405. Code No. 43714.

End. No. 3.

Premium \$ Nil

Total \$ Nil

Kind: First Excess Comprehensive Public Liability Insurance.

Term: September 1, 1954 to September 1, 1957.

In consideration of the premium charged, it is understood and agreed that wherever the assured has contracted to protect any individual, firm, or corporation by insurance such individual, firm, or corporation shall be deemed an assured under this policy but the liability of the underwriters as respects such individual, firm, or corporation shall be

limited to the amount of insurance contracted to be carried by the assured but in no event shall such liability in the aggregate exceed the underwriters' limit of liability as expressed in this policy. It is understood, however, that this policy does not insure any individual, firm, or corporation whose operations or business is not incidental or necessary to the business of the assured herein named.

United States Internal Revenue Documentary Stamps in the amount shown above, applicable to this insurance have been affixed to the Office Record of this endorsement. The law provides for no Federal Tax refund once the insurance attaches.

The effective date of this endorsement is September 1, 1954.

All other terms and conditions remain unchanged.

This endorsement is attached to and made a part of Certificate No. EB 32914-C.

Issued to: Louis Stores, Inc. Broker: Charles Epstein Company. Date of issue: 11/4/54. By: rf. Contract 54/2405. Code No. 43714

Service of Suit Clause (U. S. A.)

It is agreed that in the event of the failure of Underwriters hereon to pay any amount claimed to be due hereunder, Underwriters hereon, at the request of the insured (or reinsured), will submit to the jurisdiction of any Court of competent jurisdiction within the United States and will comply with all requirements necessary to give such Court jurisdiction and all matters arising hereunder shall be determined in accordance with the law and practice of such Court.

It is further agreed that service of process in such suit may be made upon Surplus Line Adjusting Company, Swett & Crawford and/or J. T. Ryan as agents for Mendes & Mount, and that in any suit instituted against any one of them upon this contract, Underwriters will abide by the final decision of such Court or of any Appellate Court in the event of an appeal.

The above-named are authorized and directed to accept service of process on behalf of Underwriters in any such suit and/or upon the request of the insured (or reinsured) to give a written undertaking to the insured (or reinsured) that they will enter a general appearance upon Underwriters' behalf in the event such a suit shall be instituted.

Further, pursuant to any statute of any state, territory or district of the United States which makes provision therefor, Underwriters hereon hereby designate the Superintendent, Commissioner or Director of Insurance or other officer specified for that purpose in the statute, or his successor or successors in office, as their true and lawful attorney upon whom may be served any lawful process in any action, suit or proceeding instituted by or on behalf of the insured (or reinsured) or any beneficiary hereunder arising out of this contract of insurance (or reinsurance), and hereby designate the above-named as the person to whom the said officer is authorized to mail such process or a true copy thereof.

[Endorsed]: Filed May 27, 1955.

[Title of District Court and Cause.]

REQUEST FOR ADMISSIONS UNDER
RULE 36

Plaintiff requests defendants, within ten (10) days after service of this request, to make the following admissions for the purpose of this action only, and subject to all pertinent objections to admissibility which may be interposed at the trial:

1. That Exhibit "A" attached hereto is a true copy of the complaint for damages filed in the Superior Court of the State of California, in and for the County of Alameda, on January 31, 1955.

2. That on the same date the aforementioned complaint was filed, January 31, 1955, Bruce Walkup, counsel for the plaintiff in the Superior Court action, filed an affidavit for the issuance of subpoenas to take the depositions of Tom Piperis, Earl Correia, Clifton Land and Donald Nolan.

3. That Exhibit "B" attached hereto is a true copy of a registered letter mailed by Edward A. Friend on February 15, 1955, to the Claims Manager of Ohio Farmers Indemnity Company, one party defendant in this action; that on the same date carbon copies of Exhibit "B" were mailed as indicated to Healy & Walcom, Louis Stores, Inc. and to Derby, Cook, Quinby & Tweedt, at their respective addresses.

4. That Ohio Farmers Indemnity Company received the registered letter reprinted as Exhibit

“B” and receipted therefor on February 16, 1955; that Ohio Farmers Indemnity Company retained the law firm of Healy & Walcom to represent the co-defendants Earl Correia, Clifton Land and Donald Nolan; that said law firm did represent said co-defendants at depositions taken on March 2, 1955, and at all subsequent times to and including the present.

5. That Exhibit “C” attached hereto is a true copy of the first amended complaint for damages filed in the Superior Court action during the first week of March 1955.

6. That Exhibit “D” attached hereto is a true copy of the answer to first amended complaint filed by Edward A. Friend on behalf of defendants Louis Stores, Inc. and Tom Piperis; that Edward A. Friend was retained by The Canadian Indemnity Company to represent said defendants in the Superior Court action.

7. That Exhibit “E” attached hereto is a true copy of the answer to first amended complaint filed by Healy & Walcom on behalf of defendants Earl Correia and Clifton Land.

8. That the Superior Court action came on for trial by jury on November 22, 23 and 28, 1955; that in said trial Leo J. Walcom appeared as counsel for defendants Earl Correia and Clifton Land; that Edward A. Friend appeared as counsel for defendants Louis Stores, Inc. and Tom Piperis; that prior to commencement of trial the action was

dismissed as to defendants Hopkins Food Center and all fictitious defendants; that defendants Land and Correia testified; that no other witness was called in their behalf by Mr. Walcom.

9. That at the close of Plaintiff's evidence the motion of defendant Tom Piperis for a judgment of non suit was granted by the court and judgment was thereupon entered in favor of said defendant.

10. That the Superior Court Judge instructed the jury in part as follows:

"If you find from the evidence that any employee of defendant Louis Stores, Inc., including either of the defendant employees, Earl Correia or Clifton Land, was negligent while acting in the course and scope of his employment for said Louis Stores, Inc., you are instructed that you must impute the negligence of said defendant employee or employees to defendant Louis Stores, Inc., and that if you believe that plaintiff is entitled to a verdict under the instructions given to you by the Court and the facts as presented in evidence, such verdict should be rendered against defendant Louis Stores, Inc., and such defendant employee or defendant employees found by you to be negligent."

11. That at the conclusion of all the evidence, argument and instructions the jury returned its verdict as follows:

In favor of plaintiff Virginia Christensen and against defendants Clifton Land and Louis Stores, Inc., in the sum of \$35,000.00, and in favor of de-

fendant Earl Correia against plaintiff Virginia Christensen; that judgment has been entered upon said verdict.

Dated: December 5, 1955.

/s/ EDWARD A. FRIEND

Attorney for Plaintiff

EXHIBIT "A"

In the Superior Court of the State of California,
in and for the County of Alameda

No. 263199

VIRGINIA CHRISTENSEN, Plaintiff,

vs.

LOUIS STORES, INC., a corporation, HOPKINS
FOOD CENTER, PIPERIS BROTHERS,
TOM PIPERIS, EARL CORREIA, CLIF-
TON LAND, DONALD NOLAN, FIRST
DOE, SECOND DOE, THIRD DOE, FIRST
DOE COMPANY and SECOND DOE COM-
PANY, Defendants.

COMPLAINT FOR DAMAGES

Plaintiff complains of defendants, and each of
them, and for a cause of action alleges that:

I.

Defendants Doe are sued pursuant to the pro-
visions of Section 474 of the California Code of
Civil Procedure.

II.

At all times herein mentioned defendant Louis Stores, Inc., was and is a corporation doing business in the State of California.

III.

At all times herein mentioned defendant Piperis Brothers was and is a partnership doing business in the City of Oakland, County of Alameda, State of California.

IV.

At all times herein mentioned defendants, Tom Piperis, First Doe and First Doe Company were doing business in the City of Oakland, County of Alameda, State of California, under the fictitious name and style of Hopkins Food Center with their principal place of business as 3925 MacArthur Boulevard, Oakland, California. Said defendants operated at said address a public market commonly referred to as Hopkins Food Center.

V.

At all times herein mentioned defendants, Louis Stores, Inc., and Second Doe Company, were tenants of defendants, Tom Piperis, First Doe and First Doe Company, operating a grocery concession or department in said Hopkins Food Center.

VI.

At all times herein mentioned defendants, Earl Correia, Clifton Land and Donald Nolan, were agents, servants and employees of defendant Louis Stores, Inc., and defendants, Tom Piperis, First Doe, First Doe Company and Second Doe Company,

and were acting in the course and scope of their employment and agency by said defendants.

VII.

At all times herein mentioned said Hopkins Food Center was so constructed and laid out that there were public aisles or thoroughfares running throughout said market. Said market consisted of various concessions, including a meat department, a produce department and a grocery department. Said public aisles or thoroughfares running throughout said market ran through said grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company. Said aisles and particularly the aisles running through said grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company, were open for the use of customers of said market and of said Louis Stores, Inc., and Second Doe Company.

VIII.

On or about September 17, 1954, at or about 7:00 p.m. of said day, plaintiff was a business invitee of defendants above named in said Hopkins Food Center and in said grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company, and was walking in an aisle open to the customers of said market and located in the grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company.

IX.

At said time and place defendants, and each of them, so carelessly and negligently operated, main-

tained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner so as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery department thereof lawfully using said aisle.

X.

As a direct and proximate result of said carelessness and negligence of defendants, and each of them, as aforesaid, plaintiff was caused to trip and fall over said cardboard carton in said aisle and as a direct and proximate result of said fall in said aisle as aforesaid plaintiff received the injuries and damages hereinafter set forth.

XI.

By reason of the premises plaintiff received the following injuries: Shock to her nervous system, comminuted fracture of the right olecranon, comminuted fracture of the right coronoid process, fracture of the proximal shaft of the right ulna, comminuted impacted fracture of the head of the right radius, injury to the ulnar nerve in the right arm, injury to her right shoulder and neck and other injuries presently undiagnosed.

Plaintiff is informed and believes, and therefore alleges upon such information and belief, that certain of said injuries will be permanent in nature, the extent of said permanent injuries being unknown to plaintiff at this time.

XII.

By reason of the premises it became necessary for plaintiff to incur expenses for hospitals, doctors, nurses, X-ray technicians and other services required in the care and treatment of her said injuries, and plaintiff's damage in this respect is presently unascertained as said services are still continuing, and plaintiff prays leave to insert her elements of damage in this respect when the same are finally determined.

XIII.

At all times prior to September 17, 1954, plaintiff was physically able and in good health and was self-employed as a delicatessen operator and was operating a delicatessen known as Virginia's Delicatessen located in said Hopkins Food Center at 3925 MacArthur Boulevard, Oakland, California. As a direct and proximate result of said injuries received by plaintiff as aforesaid and as a direct and proximate result of the permanent injuries and disability suffered by plaintiff as a result of said injuries as aforesaid, plaintiff has been rendered physically unable to continue with her employment as a delicatessen operator and has been forced to terminate the operation of said delicatessen permanently. Plaintiff is informed and believes that she will be permanently incapacitated from engaging in her former employment as a delicatessen operator. Prior to said injuries plaintiff made a profit of approximately \$3,000.00 per year from the operation of said delicatessen and plain-

tiff has thereby been damaged and will in the future be damaged in the sum of approximately \$3,000.00 per year because of her inability to operate said delicatessen business in the future.

XIV.

By reason of the premises plaintiff has been generally damaged in the sum of \$100,000.00.

Wherefore, plaintiff prays judgment against defendants, and each of them, as follows:

1. For general damages in the sum of \$100,000.00.
2. For special damages as prayed for herein;
3. For costs of suit; and
4. For such other and further relief as the Court deems proper.

BRUCE WALKUP

Attorney for Plaintiff

Duly Verified.

EXHIBIT "B"

Registered Mail

Return Receipt Requested

February 15th, 1955

Claims Manager

Ohio Farmers Indemnity Company

120 Bush Street

San Francisco, California

Dear Sir:

Re: Christensen vs. Louis Stores, Inc., Earl Correia, Clifton Land, Donald Nolan, et al., Alameda County No. 263199 and also your policy no. 7591 issued to Louis Stores, Inc.

I am attorney for Louis Stores, Inc. in the above

entitled action. Three employees of Louis Stores, Inc. are named as party defendants, together with the corporation itself and others. Those three are Earl Correia, Clifton Land and Donald Nolan. Demand is hereby made upon you under the above captioned policy, and, in particular, the endorsement headed "Defense of Employees," that you undertake the defense of these three defendants.

Enclosed are two copies of summons and complaint, subpoena to take deposition, and notice of taking deposition, which documents were served upon Earl Correia and Clifton Land last week. It is to be expected that Donald Nolan will be served shortly with summons and complaint and subpoena to take deposition.

Please note that depositions of various parties in this case have been calendared for February 24th, beginning at 1:00 p.m. The depositions of the three employees whose defense you are requested to assume are set for 2:00, 3:00 and 4:00 p.m.

I shall telephone the office of Bruce Walkup, attorney for the plaintiff, and request a few days time so that your defense counsel may appear on behalf of these three employees. I shall appreciate your informing me of what firm undertakes the defense so that I will be able to cooperate with such defense counsel.

Respectfully yours,

Edward A. Friend

cc's: Healy & Walcom, Louis Stores, Inc. Attn:

T. E. Louis. Derby, Cook, Quinby & Tweedt.

EAF:lk

EXHIBIT "C"

[Title of Superior Court and Cause.]

FIRST AMENDED COMPLAINT
FOR DAMAGES

Plaintiff files herein as of course her first amended complaint and complains of defendants, and each of them, and for a cause of action alleges that:

I.

Defendants Doe and sued pursuant to the provisions of Section 474 of the California Code of Civil Procedure.

II.

At all times herein mentioned defendant Louis Stores Inc., was and is a corporation doing business in the State of California.

III.

At all times herein mentioned defendants, Tom Piperis, First Doe and First Doe Company were doing business in the City of Oakland, County of Alameda, State of California, under the fictitious name and style of Hopkins Food Center with their principal place of business at 3925 MacArthur Boulevard, Oakland, California. Said defendants owned and operated at said address a public market commonly referred to as Hopkins Food Center.

IV.

At all times herein mentioned defendants, Louis Stores, Inc., and Second Doe Company, were tenants of defendants, Tom Piperis, First Doe and

First Doe Company, operating a grocery concession or department in said Hopkins Food Center.

V.

At all times herein mentioned defendants, Earl Correia and Clifton Land, were agents, servants and employees of defendant Louis Stores, Inc., and defendants, First Doe, First Doe Company and Second Doe Company, and were acting in the course and scope of their employment and agency by said defendants.

VI.

At all times herein mentioned said Hopkins Food Center was so constructed and laid out that there were public aisles or thoroughfares running throughout said market. Said market consisted of various concessions, including a meat department, a produce department and a grocery department. Said public aisles or thoroughfares running throughout said market ran through said grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company. Said aisles and particularly the aisles running through said grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company, were open for the use of customers of said market and of said Louis Stores, Inc., and Second Doe Company.

VII.

On or about September 17, 1954, at or about 7:00 p.m. of said day, plaintiff was a business invitee of defendants above named in said Hopkins Food Center and in said grocery department oper-

ated by defendants, Louis Stores, Inc., and Second Doe Company, and was walking in an aisle open to the customers of said market and located in the grocery department operated by defendants, Louis Stores, Inc., and Second Doe Company.

VIII.

At said time and place defendants, and each of them, so carelessly and negligently operated, maintained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner so as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery department thereof lawfully using said aisle.

IX.

As a direct and proximate result of said carelessness and negligence of defendants, and each of them, as aforesaid, plaintiff was caused to trip and fall over said cardboard carton in said aisle and as a direct and proximate result of said fall in said aisle as aforesaid plaintiff received the injuries and damages hereinafter set forth.

X.

By reason of the premises plaintiff received the following injuries: Shock to her nervous system, comminuted fracture of the right olecranon, comminuted fracture of the right coronoid process, fracture of the proximal shaft of the right ulna, comminuted impacted fracture of the head of the

right radius, injury to the ulnar nerve in the right arm, injury to her right shoulder and neck, further injury to her previously defective hearing and other injuries presently undiagnosed.

Plaintiff is informed and believes, and therefore alleges upon such information and belief, that certain of said injuries will be permanent in nature, the extent of said permanent injuries being unknown to plaintiff at this time.

XI.

By reason of the premises it became necessary for plaintiff to incur expenses for hospitals, doctors, nurses, X-ray technicians and other services required in the care and treatment of her said injuries, and plaintiff's damage in this respect is presently unascertained as said services are still continuing, and plaintiff prays leave to insert her elements of damage in this respect when the same are finally determined.

XII.

At all times prior to September 17, 1954, plaintiff was physically able and in good health and was self-employed as a delicatessen operator and was operating a delicatessen known as Virginia's Delicatessen located in said Hopkins Food Center at 3925 MacArthur Boulevard, Oakland, California. As a direct and proximate result of said injuries received by plaintiff as aforesaid and as a direct and proximate result of the permanent injuries and disability suffered by plaintiff as a result of said injuries as aforesaid, plaintiff has been rendered physically unable to continue with her em-

ployment as a delicatessen operator and has been forced to terminate the operation of said delicatessen permanently. Plaintiff is informed and believes that she will be permanently incapacitated from engaging in her former employment as a delicatessen operator. Prior to said injuries plaintiff made a profit of approximately \$3,000.00 per year from the operation of said delicatessen and plaintiff has thereby been damaged and will in the future be damaged in the sum of approximately \$3,000.00 per year because of her inability to operate said delicatessen business in the future.

XIII.

By reason of the premises plaintiff has been generally damaged in the sum of \$50,000.00.

Wherefore, plaintiff prays judgment against defendants, and each of them, as follows:

1. For general damages in the sum of \$50,000.00;
2. For special damages as prayed for herein;
3. For costs of suit; and
4. For such other and further relief as the Court deems proper.

BRUCE WALKUP,
Attorney for Plaintiff

EXHIBIT "D"

[Title of Superior Court and Cause.]

ANSWER TO FIRST AMENDED COMPLAINT

Come now defendants Louis Stores, Inc., a corporation, and Tom Piperis, and answering plain-

tiff's first amended complaint for damages plead as follows:

I.

Admit the allegation of paragraph II.

II.

Answering paragraph III, defendant Tom Piperis admits that on September 17, 1954, he was the owner of those certain premises located at 3925 MacArthur Boulevard, Oakland, California; defendant Tom Piperis admits and alleges in that connection that the aforesaid premises housed several independent businesses and that the premises had the collective name of "Hopkins Food Center"; defendant Piperis further alleges in this connection that "Hopkins Food Center" is merely a name designated for the convenience of his tenants, and that "Hopkins Food Center" is no legal entity of any kind, corporate, partnership or otherwise, and that "Hopkins Food Center" transacts no business of any kind; hence this defendant Piperis denies the allegations that he was doing business under the name and style of "Hopkins Food Center" or that he operated a public market, except in the sense that he leased certain portions of the premises located at 3925 MacArthur Boulevard to certain tenants operating independent businesses.

III.

Answering paragraph IV, these defendants admit that the defendant Louis Stores, Inc. was a tenant of defendant Tom Piperis and that Louis

Stores, Inc. was operating a grocery store in "Hopkins Food Center."

IV.

Answering paragraph V, these defendants admit that Earl Correia and Clifton Land were employees of defendant Louis Stores, Inc.

V.

Answering paragraph VI, these answering defendants admit the allegations therein contained in so far as said allegations apply to these defendants, or either of them.

VI.

Answering paragraph VIII, these answering defendants deny each and every allegation therein contained.

VII.

Answering paragraphs VII, IX, X, XI, XII and XIII, these defendants allege that they have no information nor belief sufficient to enable them to plead to the allegations therein contained and, basing their denial on that ground, deny each and every such allegation and deny, furthermore, that the plaintiff has been damaged in the amounts therein named, or in any other amount.

VIII.

As a separate and distinct answer and defense, these defendants allege that the plaintiff was herself careless and negligent in and about the accident described in the complaint and the injuries, if any, resulting therefrom in that she failed to use ordinary care for her own safety in looking where

she was walking; that plaintiff's carelessness and negligence as aforesaid proximately contributed to causing said accident and the injuries, if any, resulting therefrom.

IX.

As a further separate and distinct answer and defense, these defendants allege that the accident described in the first amended complaint and the injuries, if any, resulting therefrom constituted an unavoidable accident, without fault on the part of these answering defendants, or either of them.

Wherefore these answering defendants pray that plaintiff take nothing by her complaint and that they be hence dismissed with their costs.

EDWARD A. FRIEND,

Attorney for defendants Louis
Stores, Inc. and Tom Piperis

EXHIBIT "E"

[Title of Superior Court and Cause.]

ANSWER TO FIRST AMENDED COMPLAINT

Come now the defendants Earl Correia and Clifton Land, and in answer to the first amended complaint of plaintiff on file herein, admit, deny and allege:

I.

These answering defendants are not required to answer the allegations of Paragraphs I, II, III, IV, V, VI and VII of said complaint.

II.

Answering the allegations of Paragraphs VIII,

IX and XIII of said complaint, these answering defendants deny each and every, all and singular, generally and specifically, the allegations contained therein; deny that plaintiff has been damaged in the sum of \$75,000.00, or in any sum, or at all.

III.

Answering the allegations of Paragraphs X, XI and XII of said complaint, these answering defendants allege that they have no information or belief upon the subject sufficient to enable them to answer the said allegations, and placing their denial upon that ground deny each and every, all and singular, generally and specifically, the allegations contained therein.

As and for a second, separate, distinct and further answer and defense to the complaint of plaintiff, these answering defendants allege:

That plaintiff was guilty of contributory negligence in and about the matters and things set forth in said complaint and that she failed to use due or any care or caution for her own safety and protection, and failed to exercise her natural faculties, including that of eyesight, and that any and all damage sustained by plaintiff, if any such there was, was caused by her contributory negligence.

As and for a third, separate, distinct and further answer and defense to the complaint of plaintiff, these answering defendants allege:

That the damages or injuries, if any such there were, of which plaintiff now complains, were caused by unavoidable accident and without any fault of these answering defendants contributing thereto.

Wherefore, these answering defendants pray that plaintiff take nothing by her complaint and that the same be dismissed herefrom with costs to defendants.

HEALY AND WALCOM,

By LEO J. WALCOM,

Attorneys for Defendants Earl Correia and Clifton Land

Duly Verified.

Certificate of Service by Mail attached.

[Endorsed]: Filed December 6, 1955.

[Title of District Court and Cause.]

OPINION

Edward A. Friend, 519 California Street, San Francisco 4, California, Attorney for Plaintiff. Leo J. Walcom, 68 Post Street, San Francisco 4, California, Attorney for Defendant Ohio Farmers Indemnity Company. Lloyd M. Tweedt, Esq., Derby, Cook, Quinby & Tweedt, 1000 Merchants Exchange Building, San Francisco 4, California, Attorneys for Defendants Underwriters at Lloyd's.

Hamlin, District Judge.

Complaining of personal injuries suffered in a certain store on September 17, 1954, one Virginia Christensen began an action against the owner of the store, Louis Stores, Inc. and one of its employees, Clifton Land, among others. Her original complaint was filed on January 31, 1955, and an amended complaint was filed on March 9, 1955, in which she alleged that each of the above defend-

ants negligently operated and maintained the store and a certain aisle therein, proximately causing her injuries. Louis Stores, Inc. and Land answered the complaint on March 14 and March 23, respectively, denying negligence and alleging contributory negligence on the part of Christensen. A trial was had before a jury which returned its verdict in favor of the plaintiff and against Louis Stores, Inc. and Land for \$35,000, and judgment was entered against these defendants in this amount. That Judgment has now become final. The present action was begun when Canadian Indemnity Company filed a complaint against Ohio Farmers Insurance Company on October 28, 1954, asking for declaratory relief as to the rights of the parties regarding the liability of Louis Stores, Inc. An amended complaint seeking the same relief was filed on January 5, 1955 against Ohio and two groups of underwriters at Lloyd's London who had excess coverage on Louis Stores, Inc. above the Ohio policy.

The plaintiff in this action contends that the verdict against Louis Stores, Inc. was rendered solely on the theory of respondeat superior, and that therefore under the doctrine of *Canadian Indemnity Co. v. U. S. Fidelity & Guaranty Co.*, 9 Cir., 213 F. 2d 658, the employer Louis Stores, Inc. can recover from its employee Land on the ground that Land's negligence was the sole cause of the accident. The defendant contends that there is no way of determining whether the finding of the jury was on the basis of Land's sole negligence or whether the jury's finding was that each

party was independently negligent. The accident occurred between 7 and 9 p.m., when the plaintiff tripped over a carton of bottled water which had been left in an aisle in a market operated by Louis Stores, Inc. At that time, Land was the only adult employee on duty and his primary duties, according to his testimony, required his attendance at the check stand where customers were receiving their purchases. While attending his duties at the check stand he had allowed the offending carton which had been placed there by a courtesy boy, a minor, to remain in the aisle. From the evidence presented, the Court is unable to say that the finding of respondeat superior was the only finding that could have been made. The jury may have found Louis Stores, Inc. negligent in not providing enough employees or in not properly instructing its employees what to do. There was enough evidence on which to base such a finding, and the jury were instructed that they could return a verdict against Louis Stores, Inc. and not against Land. The evidence at the trial could not remove the possibility that the jury made a finding that each defendant was independently negligent.

Plaintiff further relies for recovery upon establishing that Land was an insured under the Ohio Farmers policy. Land was not included in the definition of the insured in that policy,¹ and from a

¹ The Ohio Farmers policy reads as follows, in material part:

“Item 1. Name of Insured Louis Stores, Inc. * * *

“Insuring Agreements * * * III. Definition of Insured. The unqualified word ‘Insured’ includes

reading of Endorsement #4 of that policy² it

the Named Insured and also includes (1) under Coverages B and D, any partner, executive officer, director, or stockholder thereof while acting within the scope of his duties as such, and (2) under Coverages A and C, any person while using an owned automobile or a hired automobile and any person or organization legally responsible for the use thereof, provided the actual use of the automobile is by the Named Insured or with his permission, and any executive officer of the Named Insured with respect to the use of a non-owned automobile in the business of the Named Insured.
* * *

² "Defense of Employees"

"1. The Company will defend, if and when requested in writing to do so by the Named Insured in the name and on behalf of any employee of the Insured, any suit alleging Bodily Injury, death or any set [sic] covered by this policy or any endorsement attached thereto, and will pay all costs taxed against such employee in any suit, provided, however, that the Named Insured either is joined or if not joined, could properly have been joined as defendant in such suit, and provided further, that the suit either is one which this company is obligated under said policy to defend on behalf of said Named Insured, or is one which this company would have been so obligated to defend if said Named Insured had been joined as a defendant.

"2. The Company will also pay any loss by liability imposed upon any said employees by final judgment in any such suit and will pay all interest accruing after entry of said final judgment upon such part of same as is not in excess of the Company's limits of liability as specified in the Declarations.

"3. It is understood and agreed that this Policy of Insurance is a contract between the Ohio Farmers Indemnity Company and the Named Insured and that nothing herein shall be construed as creating any privity of contract between the Ohio

would appear that Land had no right against Ohio Company to insist that he was insured or that coverage be extended to him or that certain benefits of the policy would flow to him. Endorsement #4 further provided that there was no privity of contract between Land and Ohio. From the language of the policy, the Court cannot find that Land is an insured under that policy.

The language of the Canadian and Ohio policies with respect to other insurance is identical with that involved in *Air Transport Mfg. Co. v. Employers Liability Corp.*, 204 P. 2d 647, in which the Court held that the liability of the insurers should be prorated. This is also the rule of *Oregon Auto Ins. Co. v. U. S. Fidelity & Guaranty Co.*, 9 Cir., 195 F. 2d 958. Therefore, it is the opinion of this Court that the rights of the parties in respect to the liability of Louis Stores, Inc., is that Canadian pay ten-elevenths of any judgment, and Ohio pay one-eleventh. Since the two policies of Lloyd's are effective only after the Ohio policy is exhausted, the Lloyd's policies are not liable at all in the situation presented here.

Dated: April 20, 1956.

/s/ O. D. HAMLIN,

United States District Judge

[Endorsed]: Filed April 20, 1956.

Farmers Indemnity Company and any employees of the Named Insured, nor shall this paragraph confer any rights upon said employees which said employees would not have had if this paragraph had not been written. * * *"

[Title of District Court and Cause.]

FINDINGS OF FACT AND CONCLUSIONS OF LAW

The above entitled cause came on regularly for trial on the 27th day of January, 1956, before the Court sitting without a jury, a jury having been duly waived by the parties;

Edward A. Friend, Esq. appeared as attorney for plaintiff The Canadian Indemnity Company, a corporation; Leo J. Walcom, Esq. appeared as attorney for defendant Ohio Farmers Indemnity Company, a corporation; Derby, Cook, Quinby & Tweedt, by Lloyd M. Tweedt, Esq. appeared as attorneys for defendants The Prudential Assurance Company Limited of London, a corporation, and Frank B. Allison and other Underwriters at Lloyd's London subscribing to Lloyd's policy No. 32913-L;

Evidence, both oral and documentary, having been introduced and the cause submitted for decision, the Court now, after due deliberation thereon and consideration of the arguments of counsel, finds the facts and makes the conclusions of law as follows:

I.

Plaintiff is now and was at all times herein mentioned a corporation organized and existing under the laws of Canada.

Defendant Ohio Farmers Indemnity Company is now and was at all times herein mentioned a cor-

poration organized and existing under the laws of the State of Ohio.

Defendant The Prudential Assurance Company Limited of London is now and was at all times herein mentioned a corporation organized and existing under the laws of the United Kingdom of Great Britain and Ireland.

Defendants Frank B. Allison and other underwriters at Lloyd's London subscribing to policy No. 32913-L are now and were at all times herein mentioned, residents and subjects of the United Kingdom of Great Britain and Ireland.

II.

The matter in controversy exceeds, exclusive of interest and costs, the sum of Three Thousand Dollars (\$3,000.00).

On or about January 31, 1955, one Virginia Christensen filed a complaint in the Superior Court of the State of California, in and for the County of Alameda, numbered 263199 therein, against Louis Stores, Inc., a corporation, Hopkins Food Center, Piperis Brothers, Tom Piperis, Earl Correia, Clifton Land and Donald Nolan. On or about March 9, 1955, said Virginia Christensen filed an amended complaint in said action. Said amended complaint alleged that said Virginia Christensen suffered personal injuries on September 17, 1954, while shopping in a store operated by defendant Louis Stores, Inc.; that defendants, and each of them, so carelessly and negligently operated, maintained and controlled said market and said grocery department

therein, and said aisle open to the public therein, so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery thereof lawfully using said aisle, and that as a result thereof the plaintiff was injured. Defendants Tom Piperis, Hopkins Food Center, Louis Stores, Inc., Clifton Land and Earl Correia answered said amended complaint, denying negligence and alleging contributory negligence.

Plaintiff in said action dismissed as against Hopkins Food Center and all fictitious defendants. The motion of defendant Tom Piperis for nonsuit was granted, so that the action was submitted to the jury as to defendants Earl Correia, Clifton Land and Louis Stores, Inc. The jury returned a verdict in favor of plaintiff against Clifton Land and Louis Stores, Inc.; and against plaintiff in favor of defendant Earl Correia. The amount of the judgment was \$35,000.00 as entered on said verdict and the judgment has now become final.

Paragraph V of the first amended complaint alleged that defendants Earl Correia and Clifton Land were the employees of defendant Louis Stores, Inc. This allegation was admitted by the answers of Tom Piperis and Louis Stores, Inc.

The Court instructed the jury in said action on the doctrine of respondeat superior and also instructed the jury that they could find a verdict against Louis Stores, Inc. and not against its em-

ployee, Clifton Land. The Court also gave to the jury in said action a form of verdict which found in favor of plaintiff Virginia Christensen and against defendant Louis Stores, Inc., and which further found in favor of defendant Clifton Land.

IV.

It cannot be determined whether the verdict and judgment against Louis Stores, Inc., in said Christensen action was based on independent negligence on the part of said Louis Stores, Inc. and/or on the basis of respondeat superior for the acts or omissions of its employee, Clifton Land. There is sufficient evidence in the record to support a verdict upon either basis.

V.

Plaintiff The Canadian Indemnity Company issued a policy of insurance number 25 CPL 1911, insuring said Louis Stores, Inc. against liability for bodily injuries to a person or persons injured on the premises of said store to a limit of \$100,000.00. Said policy was in force and effect at the time said Virginia Christensen was injured. Said policy did not insure said Clifton Land. Said policy contained another insurance clause reading as follows:

“Other Insurance—If at the time of an accident there is any other insurance available to the insured (in this or any other carrier) there shall be no insurance afforded hereunder as respects such accident except that if the applicable limit of liability of this policy is in excess of the applicable

limit provided by the other insurance available to the insured this policy shall afford excess insurance over and above such other insurance in an amount sufficient to afford the insured a combined limit of liability equal to the applicable limit of liability afforded by this policy. It is further provided that in respect of loss arising out of the operating, maintenance or use of any non-owned automobile other than a hired automobile, the applicable insurance afforded by this policy shall be excess over and above such other available insurance. Insurance under this policy shall not be construed to be concurrent or contributing with any other insurance which is available to the insured."

VI.

Defendant Ohio Farmers Indemnity Company issued a policy of insurance, number CL 7591, insuring said Louis Stores, Inc. against liability for bodily injuries to persons injured on the premises of said store to a limit of \$10,000.00 each person. Said policy was in force and effect at the time said Virginia Christensen was injured. Said policy of Ohio Farmers Indemnity Company contains a typewritten endorsement No. 4 reading as follows:

"Defense of Employees

The Company will defend, if and when requested in writing to do so by the Named Insured in the name and on behalf of any employee of the insured, any suit alleging Bodily Injury, death or any set covered by this policy or any endorsement attached thereto, and will pay all costs taxed against such

employee in any suit, provided, however, that the Named Insured either is joined or if not joined, could properly have been joined as defendant in such suit, and provided further, that the suit either is one which this company is obligated under said policy to defend on behalf of said Named Insured, or is one which this company would have been so obligated to defend if said Named Insured had been joined as a defendant.

2. The Company will also pay any loss by liability imposed upon any said employees by final judgment in any such suit and will pay all interest accruing after entry of said final judgment upon such part of same as is not in excess of the Company's limits of liability as specified in the Declarations.

3. It is understood and agreed that this Policy of Insurance is a contract between the Ohio Farmers Indemnity Company and the Named Insured and that nothing herein shall be construed as creating any privity of contract between the Ohio Farmers Indemnity Company and any employees of the Named Insured, nor shall this paragraph confer any rights upon said employees which said employees would not have had if this paragraph had not been written.

4. It is further understood and agreed that anything herein above or elsewhere contained or expressed to the contrary notwithstanding, the Company will under no circumstances whatsoever provide Coverage except where the act of the employee was committed in good faith and is within the scope of employment.

5. The insurance provided by this endorsement shall be excess insurance over any other valid and collectible insurance available to any employee of the Named Insured."

Said policy did not insure Clifton Land. Said policy contained another insurance clause reading as follows:

"Other Insurance. If the Insured has other insurance against a loss covered by this policy the Company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the Declarations bears to the total applicable limit of liability of all valid and collectible insurance against such loss; provided, however, the insurance under this policy with respect to loss arising out of the use of any non-owned or hired automobile shall be excess insurance over any other valid and collectible insurance available to the Insured, either as an Insured under a policy applicable with respect to such automobile or otherwise."

VII.

The said policies of insurance issued by plaintiff The Canadian Indemnity Company and defendant Ohio Farmers Indemnity Company, respectively, afforded protection and indemnity to Louis Stores, Inc. against the liability created by the judgment in favor of said Virginia Christensen; and each of said policies was written and issued as primary insurance and each, in the absence of the other, primarily insured within policy limits against the liability of Louis Stores, Inc. arising from said

judgment. There are no facts on the basis of which the provisions of either of said policies with respect to other insurance should or may be reasonably preferred to the other and the total liability of Louis Stores, Inc. under said judgment should be pro-rated between said two insurers on the basis of their respective policy limits.

VIII.

Defendant The Prudential Assurance Company Limited of London issued a policy of insurance, number EB 32914-C, insuring said Louis Stores, Inc. against liability for bodily injuries to persons injured on the premises of said store for a limit of \$40,000.00 each person excess over the \$10,000.00 limit provided for in said policy of Ohio Farmers Indemnity Company. Said policy issued by said The Prudential Assurance Company Limited of London further provided that liability shall attach thereunder only after the said primary insurer has paid or has been held liable to pay the sum of \$10,000.00 to any one person for bodily injuries. Said policy did not insure said Clifton Land.

IX.

Defendants Frank B. Allison and other underwriters at Lloyd's, London, issued a policy of insurance number EB 32913-L, insuring said Louis Stores, Inc. against liability for bodily injuries to persons injured on the premises of said store for a limit of \$450,000.00 each person excess over the combined limits of \$50,000.00 provided for in said policies of said Ohio Farmers Indemnity Company

and The Prudential Assurance Company, Limited, of London. Said policy No. 32913-L further provided that liability thereunder shall attach only after said primary insurer and first excess insurer have paid or have been liable to pay the sum of \$50,000.00 to any one person for bodily injuries. Said policy did not insure said Clifton Land.

Conclusions of Law

I.

Said Louis Stores, Inc. and Clifton Land were held jointly liable by the verdict and judgment against them in favor of Virginia Christensen.

II.

Clifton Land was not an insured under any of the policies of insurance issued by plaintiff or by defendants and is not entitled to enforce the provisions of any said policies.

III.

The policies of insurance issued by The Canadian Indemnity Company and by Ohio Farmers Indemnity Company insured the liability of Louis Stores, Inc. arising by virtue of the judgment in favor of said Virginia Christensen; that said policies constituted concurrent insurance against said liability; that said insurers are obligated to respond to and satisfy said judgment in the following proportions: ten-elevenths by The Canadian Indemnity Company; one-eleventh by Ohio Farmers Indemnity Company.

IV.

The policy of excess insurance number EB 32914-C, issued by The Prudential Assurance Company Limited of London does not attach to the liability of Louis Stores, Inc. under said judgment and said insurer is not obligated to respond to nor to satisfy said judgment or any part thereof.

V.

The policy of second excess insurance, number EB 32913-L, issued by Frank B. Allison and other underwriters at Lloyd's London does not attach to the liability of said Louis Stores, Inc. under said judgment and said insurers are not obligated to respond to nor to satisfy said judgment or any part thereof.

VI.

Defendants, and each of them, are entitled to judgment for their costs of suit herein against plaintiff.

Let judgment be entered accordingly.

Dated: June 5, 1956.

/s/ O. D. HAMLIN,

United States District Judge

[Endorsed]: Filed June 5, 1956.

In the District Court of the United States, Northern District of California, Southern Division

No. 34158

THE CANADIAN INDEMNITY COMPANY, a
corporation, Plaintiff,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, JOHN DOE, and all other underwriters at Lloyd's London subscribing to Lloyd's Policy No. EB 32914-C; RICHARD ROE and all other underwriters at Lloyd's London subscribing to Lloyd's Policy No. EB 32913-L, Defendants.

JUDGMENT

This cause came on regularly for trial before the Court sitting without a jury, the parties having appeared by their respective counsel and the issues having been duly tried and argued, and the Court having heretofore filed its memorandum opinion and having made its findings of fact and conclusions of law directing judgment as hereinafter provided;

Wherefore, by reason of the law and said findings of fact, it is now Ordered, Adjudged and Decreed that the rights, duties and obligations of the parties hereto are declared as follows:

1. The policies of insurance, numbers 25 CPL 1911 and CL 7591, issued respectively by plaintiff The Canadian Indemnity Company and defendant

Ohio Farmers Indemnity Company, insured the liability of Louis Stores, Inc. under the judgment in favor of Virginia Christensen against said Louis Stores, Inc. in action number 263199 in the Superior Court of the State of California, in and for the County of Alameda; that said policies constituted concurrent insurance against said liability; that said The Canadian Indemnity Company is obligated to pay ten-elevenths of the amount necessary to satisfy said judgment and said Ohio Farmers Indemnity Company is obligated to pay the remaining one-eleventh of the amount necessary to satisfy said judgment.

2. The policy of excess insurance number EB 32914-C issued by The Prudential Assurance Company Limited of London does not attach to the liability of Louis Stores, Inc. under said judgment and said insurer is not obligated to respond to nor to satisfy said judgment or any part thereof.

3. The policy of second excess insurance number EB 32913-L issued by Frank B. Allison and other underwriters at Lloyd's London does not attach to the liability of said Louis Stores, Inc. under said judgment and said insurers are not obligated to respond to nor to satisfy said judgment or any part thereof.

4. Clifton Land was not an insured under any of the policies of insurance issued by plaintiff or by defendants and is not entitled to enforce the provisions of any said policies.

5. Defendants herein, and each of them, have and recover from plaintiff The Canadian Indem-

nity Company their respective costs and disbursements taxed herein as follows:

\$..... for defendant Ohio Farmers Indemnity Company

\$..... for defendant Frank B. Allison

\$..... for defendant The Prudential Assurance Company Limited of London.

Dated: June 5, 1956.

/s/ O. D. HAMLIN

United States District Judge

Entered in Civil Docket June 5, 1956.

[Endorsed]: Filed June 5, 1956.

[Title of District Court and Cause.]

MOTION FOR A NEW TRIAL

Plaintiff The Canadian Indemnity Company hereby moves the Court that it vacate the judgment rendered on June 5, 1956, and grant plaintiff a new trial upon the grounds that the judgment rendered is not supported by the evidence and that it is contrary to law.

Dated: June 14th, 1956.

/s/ EDWARD A. FRIEND,

Attorney for Plaintiff

[Endorsed]: Filed June 15, 1956.

[Title of District Court and Cause.]

ORDER

It is hereby ordered that the plaintiff's motion for a new trial is denied.

Dated: July 26, 1956.

/s/ O. D. HAMLIN,

United States District Judge

[Endorsed]: Filed July 26, 1956.

[Title of District Court and Cause.]

NOTICE OF APPEAL

To: Defendants Ohio Farmers Indemnity Company, The Prudential Assurance Company Limited of London and All Other Underwriters of Lloyd's London Subscribing to Lloyd's Policy No. EB32914-C, and to Leo J. Walcom, Esquire, and Messrs. Derby, Cook, Quinby & Tweedt, their respective attorneys:

Notice Is Hereby Given that plaintiff The Canadian Indemnity Company, a corporation, hereby appeals to the United States Court of Appeals for the Ninth Circuit from the judgment of this court filed June 5, 1956, declaring the rights of the parties, and from each part thereof.

Dated: July 27, 1956.

/s/ EDWARD A. FRIEND,

Attorney for Plaintiff and
Appellant

Certificate of Service by Mail attached.

[Endorsed]: Filed August 1, 1956.

[Title of District Court and Cause.]

UNDERTAKING FOR COSTS ON APPEAL

Whereas, the plaintiff The Canadian Indemnity Company, a corporation, has appealed to the United States Court of Appeals for the Ninth Circuit from the judgment of declaratory relief rendered in said District Court in the above entitled cause on the 5th day of June, 1956,

Now, therefore, the undersigned surety company does hereby undertake and promise on the part of the appellant and does hereby acknowledge itself bound in the sum of \$250.00, conditioned that the appellant shall pay all costs adjudged against it in the event that the judgment is affirmed or that the appeal is dismissed, and conditioned further that the appellant shall pay such costs as the Appellate Court may award against it if judgment is modified.

Dated: This 6th day of August, 1956.

ST. PAUL-MERCURY
INDEMNITY COMPANY

[Seal] By D. KEITH JOHNSON,
Its Attorney-in-Fact

Acknowledgment of Attorney-in-Fact attached.

[Endorsed]: Filed August 8, 1956.

[Title of District Court and Cause.]

EX PARTE ORDER EXTENDING TIME FOR
FILING RECORD ON APPEAL AND
DOCKETING APPEAL

Owing to the temporary absence from the bay area of H. A. Cannon, a court reporter who reported part of the oral proceedings held in this court,

It is hereby ordered that the time for filing the record on appeal and docketing the appeal may be extended to and including the 15th day of October, 1956. (F.R.C.P. 73(g).)

Dated: September 6, 1956.

/s/ LOUIS GOODMAN,

Judge of the U. S. District Court

Certificate of Service by Mail attached.

[Endorsed]: Filed September 6, 1956.

[Title of District Court and Cause.]

CERTIFICATE OF CLERK TO RECORD ON
APPEAL

I, C. W. Calbreath, Clerk of the United States District Court for the Northern District of California, hereby certify the foregoing and accompanying documents and exhibits, listed below, are the originals filed in this Court in the above-entitled case and constitute the record on appeal herein as designated by attorneys for appellant and appellees:

Excerpt from Docket Entries

Stipulation for Filing First Amended Complaint
First Amended Complaint

Answer of Ohio Farmers Indemnity Company to
First Amended Complaint

Answer of Prudential Assurance Company of
London, a corporation (sued herein as John Doe)

Interrogatories by Plaintiff to Defendant

Answer of Defendant to Interrogatories by Plain-
tiff, with exhibits

Interrogatories by Ohio Farmers Ins. Co. to
plaintiff

Answer of Plaintiff to Interrogatories by Ohio
Farmers Ins. Co., with exhibits

Request of Plaintiff for Admissions by Defend-
ants, with exhibits

Opinion of Court

Findings of Fact and Conclusions of Law

Judgment

Proposed Modifications by Plaintiff to Findings
of Fact and Conclusions of Law

Motion of Plaintiff for New Trial

Order Denying Motion for New Trial

Notice of Appeal

Bond on Appeal

Appellant's Designation of Record on Appeal

Appellees' Designation of Record on Appeal

Order Extending Time to Docket Appeal

Stipulation for Correction of Reporter's Tran-
script

Stipulation for Correction of Reporter's Tran-
script

Stipulation for Correction of Reporter's Transcript

Reporter's Transcript of Proceedings, January 27, 1956

Reporter's Transcript of Proceedings, July 26, 1956

Plaintiff's Exhibits 1, 2 and 3

Defendants' Exhibits A and B

In witness whereof, I have hereunto set my hand and affixed the seal of said District Court this 15th day of October, 1956.

C. W. CALBREATH,
Clerk

/s/ By MARGARET P. BLAIR,
Deputy

[Title of District Court and Cause.]

MOTION FOR DECLARATORY RELIEF
REPORTER'S TRANSCRIPT

Before: Hon. Oliver D. Hamlin, Judge.

January 27, 1956

* * * * *

The Court: And so to set the record straight, it is stipulated by counsel that all of the statements contained in the requests for admissions filed December 6th, 1955, are true, is that right?

Mr. Tweedt: Yes, your Honor.

Mr. Walcott: Yes, your Honor.

The Court: Both sides stipulated. All right.

Mr. Friend: And I believe, your Honor, we have

already stipulated that no motion for a new trial nor an appeal has been filed in the Alameda County Superior Court action, and that it is contemplated that that judgment will become final by operation of law within the next two or three days because the 60-day period for appeal will have run by that time.

The Court: Is that stipulated, gentlemen?

Mr. Walcom: Yes, your Honor.

Mr. Tweedt: Yes, your Honor.

The Court: By all sides. All right.

* * * * *

[Endorsed]: Filed August 24, 1956.

[Title of District Court and Cause.]

REPORTER'S TRANSCRIPT

MOTION FOR NEW TRIAL

Thursday, July 26, 1956

* * * * *

Mr. Walcom: Now, to face reality and not be misled, counsel puts much emphasis on the demand of the insured to take over the defense of Clifton Land and cites and claims that is an admitted fact because of the request for admission not being denied. Let's not forget for a moment that no demand was ever made by Louis Stores in this case. A letter by Mr. Friend, who at that time on behalf of the Canadian Indemnity had undertaken the defense of Louis Stores, merely directed to Ohio the request, stating that he was the attorney for the Louis Stores in the above-entitled action, and I

think candor and honesty would compel the fact that he has never represented Louis Stores in its personal matters, and he asks that those defenses be taken over. But it is a false issue in that we admit that we defended Land and Correia.

* * * * *

Mr. Friend: Mr. Walcom also argues that the request that they defend was not made by the named insured. He then adds, as he must, that they did in fact defend, so that is no longer an issue. But I would like to direct the Court's attention to that specific request, which is in Exhibit B attached to the request for admissions. It was a registered letter sent to Ohio Farmers in which I say that I am the attorney for Louis Stores, Inc. in this action, which I was, and I made specific requests on behalf of Louis Stores, Inc. that Ohio Farmers defend those employees.

Now, Ohio Farmers might conceivably have written back to me saying: You do not represent Louis Stores, Inc., you are an imposter representing Canadian Indemnity Company, and we do not recognize your request. But they did not do that. They defended pursuant to such request and they cannot be heard at this time to say that there was no request by the named insured.

* * * * *

[Endorsed]: Filed September 25, 1956.

[Endorsed]: No. 15335. United States Court of Appeals for the Ninth Circuit. Canadian Indemnity Company, a corporation, Appellant, vs. Ohio Farmers Indemnity Company and Prudential Assurance Company of London, Appellees. Transcript of Record. Appeal from the United States District Court for the Northern District of California, Southern Division.

Filed: October 15, 1956.

Docketed: October 22, 1956.

/s/ PAUL P. O'BRIEN,

Clerk of the United States Court of Appeals for the Ninth District.

United States Court of Appeals
for the Ninth Circuit

No. 15335

THE CANADIAN INDEMNITY COMPANY, a
corporation, Plaintiff and Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, et al.,
Defendants and Appellees.

STATEMENT OF POINTS ON APPEAL

Appellant herewith presents the points upon which it claims the District Court erred:

1. Finding, conclusion and judgment that Clifton Land was not insured under the policies of in-

surance issued by defendants herein are not supported by the evidence and are against the law.

2. Finding and conclusion that the verdict and judgment against Louis Stores, Inc., in the Alameda County Superior Court action was based on the independent negligence of Louis Stores, Inc. and not on the basis of respondeat superior for the negligence of its employee Clifton Land are not supported by the evidence and are against the law.

3. In failing to apply to the facts at bar the holding of the United States Court of Appeals for the Ninth Circuit in *Canadian Indemnity Co. v. U. S. F. & G.*, 213 Fed. (2d) 658, affirming *U. S. F. & G. v. Canadian Indemnity Co.*, 107 Fed. Supp. 683.

4. In failing to find that Clifton Land was the only active tort feisor, even if Louis Stores, Inc. was independently negligent toward the plaintiff in the Alameda County Superior Court action, and that hence the onus of paying the personal injuries judgment rendered in the Superior Court should fall upon Clifton Land and his insurers.

/s/ EDWARD A. FRIEND,
Attorney for Appellant

Certificate of Service by Mail Attached.

[Endorsed]: Filed October 22, 1956. Paul P. O'Brien, Clerk.

No. 15,335
United States Court of Appeals
For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and
all other underwriters at Lloyd's
London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

**Appeal from the United States District Court for the
Northern District of California,
Southern Division.**

APPELLANT'S OPENING BRIEF.

EDWARD A. FRIEND,

519 California Street,

San Francisco 4, California,

Attorney for Appellant.

FILED

MAR - 4 1957

PAUL P. O'BRIEN, CLERK



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United States Court of Appeals For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and
all other underwriters at Lloyd's
London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

APPELLANT'S OPENING BRIEF.

PROCEEDINGS BELOW AND STATEMENT OF FACTS.

Plaintiff-Appellant filed suit for declaratory relief in the District Court against Defendants-Appellees under 28 U.S.C. 2201 and 2202. Federal jurisdiction exists under 28 U.S.C. 1332 on the ground of alienage: Plaintiff is a Canadian corporation, defendant Ohio Farmers is an Ohio corporation, all other de-

fendants are subjects of Britain, and the amount in controversy exceeds \$3000, exclusive of interest and costs.

Plaintiff Canadian's first amended complaint in declaratory relief appears at R. 3-5. The complaint alleges that Canadian insured the liability of one Louis Store, a grocery store located on MacArthur Boulevard, Oakland, to the extent of \$100,000; that one Virginia Christensen was allegedly injured in said store on September 17, 1954, as the result of the negligence of an employee or employees of said store; that defendants also carried liability insurance in favor of Louis Stores; and that plaintiff sought adjudication of its obligations and those of defendants to pay any liability that might be assessed against Louis Stores, Inc., and its employees in favor of Virginia Christensen.

Ohio Farmers Indemnity Company answered the amended complaint in declaratory relief, R. 5-7. It admitted having a policy in favor of Louis Stores, Inc., in the sum of \$10,000.

Defendant Prudential Assurance Company Limited of London and other Lloyd's underwriters answered plaintiff's amended complaint, R. 7-22, appending to its answer as an exhibit a complete copy of its policy. It admitted having an "excess policy" in favor of Louis Stores, Inc., and, as appears from the text of the policy at R. 13, the Ohio Farmers' policy is defined as the "underlying policy" and is referred to in the Lloyd's policy as the "primary insurers." The

Lloyd's underwriters, by this policy, obligated themselves to pay \$40,000 after the \$10,000 provided by Ohio Farmers had become exhausted. Clause 5 of the Lloyd's policy, as printed at R. 16, is headed "Maintenance of Primary Insurance." It says that the Lloyd's policy is subject to the same warranties, terms and conditions "as are contained in or may be added to the policy of the primary insurers prior to the happening of an accident for which claim is made hereunder. . . ."

As may be seen from Endorsement No. 3 to the Lloyd's policy, as printed at R. 20, the Lloyd's underwriters agreed as follows:

"In consideration of the premium charged, it is understood and agreed that wherever the assured has contracted to protect any individual, firm, or corporation by insurance such individual, firm, or corporation shall be deemed an assured under this policy . . ."

The Ohio Farmers' policy had an endorsement entitled "Defense of Employees." That endorsement, Endorsement No. 4 to the Ohio Farmers' policy, was typewritten, not printed. It is quoted in full in Finding No. V1, as amended, of the District Court at R. 51-53. The policy issued by plaintiff Canadian to Louis Stores, Inc., contains no such endorsement.

After the instant declaratory relief action had been commenced by Canadian in the United States District Court, Virginia Christensen commenced an action to recover damages for personal injuries in the Superior

Court of the State of California, in and for the County of Alameda. This Superior Court action was filed against Louis Stores, Inc., two of its employees, namely, Earl Correia and Clifton Land, and other defendants, as to whom nonsuits were later granted. Concerning said Superior Court suit, the handling of its defense and its result, attention is respectfully directed to plaintiff's request for admissions filed in the District Court with Exhibits "A", "B", "C", "D" and "E" attached thereto. Said request for admissions and all exhibits are reprinted at R. 23-42, and it was stipulated in open court that all statements therein contained are true, as shown by the excerpts from the reporter's transcript printed at R. 64-65. It is clear from Exhibit "B", attached to said request for admissions and reprinted at R. 31-32, that the writer of this brief, as attorney for Louis Stores, Inc., in the Superior Court action, made written demand upon Ohio Farmers Indemnity Company that it undertake the defense of the named employees Correia and Land under its policy issued to Louis Stores, Inc.; and particularly under its Endorsement No. 4 to that policy hereinabove referred to. It is also clear that Ohio Farmers did undertake the defense of said employees, pursuant to such written demand: Paragraph 4 of request for admissions printed at R. 23-24.

The first amended complaint for damages in the Superior Court action appears at R. 33-37, as Exhibit "C" to the request for admissions. It is the complaint upon which issue was joined in the Superior

Court and upon which trial was had. Paragraph V of said Superior Court complaint, at R. 34, alleges that Land and Correia were employees of Louis Stores, Inc., and were acting in the scope and course of their employment. Paragraph VIII of said complaint, at R. 35, contains the essentials of the charge of negligence: In essence, that defendants caused and permitted a cardboard carton to be in an aisle of the grocery store in such manner as to render the aisle dangerous to the passage of customers. As a consequence of such negligence, it appeared that Mrs. Christensen tripped over the cardboard carton in the aisle and sustained serious injuries when she fell to the floor.

Louis Stores, Inc., admitted, in paragraph IV of its answer at R. 39, that Land and Correia were employees.

Land and Correia, appearing by the law firm retained for that purpose by Ohio Farmers, pursuant to written demand under their policy hereinabove referred to, filed an answer to the amended Superior Court complaint, which answer appears at R. 40-42. In paragraph I of said answer, the answering defendants allege that they "are not required" to answer the allegation of that paragraph of the complaint containing the allegation of employment.

The Superior Court action was tried to a jury. Land and Correia testified in their own behalf and no other witness was called in their behalf by their counsel, Mr. Walcom, paragraph 8 of plaintiff's re-

quest for admissions in the District Court, printed at R. 24-25.

The complete testimony of Earl Correia and Clifton Land, as given in the Superior Court, was reprinted and was received in evidence by the District Court at the trial of this case as plaintiff's exhibits 1 and 2. It appeared from the testimony of those two parties in the Superior Court action that Correia was the manager of the Louis Store in question on the date of Mrs. Christensen's accident. Correia determined how many employees were necessary at any particular hour and Correia instructed them as to their duties, Correia's testimony, page 9. Correia realized the hazard presented by a box left in the aisle of a grocery store and for that reason instructed the man on duty always to stock a particular shelf until any one box was empty and then to get the box out of the aisle, as shown by page 10 of Correia's testimony. Earl Correia inspected the grocery department thoroughly when he left for the day, shortly before the occurrence of this accident; at that time, all of the aisles were clear, Correia's testimony, page 7.

Mrs. Christensen was injured between seven and nine in the evening. During those hours on this particular night, Clifton Land, an employee of Louis Stores, Inc., was in charge of the grocery department, assisted only by Donald Nolan, a sixteen-year-old "courtesy boy," who ran errands and swept the floors, but who was not permitted to take stock out of boxes and put the stock on the shelves; this work had to be done only by a clerk, Correia's testimony, page 9.

A customer asked Clifton Land for a bottle of Alhambra distilled water. The ensuing events are described in detail at pages 6-10 of Land's testimony. It is clear that Land, himself, deliberately left the box in the aisle, pushing it up against the "gondola" with five bottles of distilled water still remaining in the box of the six it had originally contained. It was over this box that Mrs. Christensen tripped and fell, while shopping for various groceries. Based upon this evidence, the jury returned a verdict in favor of Mrs. Christensen and against both Clifton Land and Louis Stores, Inc., his employer. The jury found in favor of defendant Earl Correia, thereby exonerating him. The verdict is reprinted as paragraph 11 of plaintiff's request for admissions at R. 25-26. That Superior Court judgment has become final and has not been satisfied.

The text of the District Court's opinion occupies one and one-quarter pages of the Federal Supplement, *Canadian Indemnity v. Ohio Farmers*, 140 F. Supp. 437. The District Court, in footnotes at 140 F. Supp. 439, quotes part of defendant Ohio Farmers' Endorsement No. 4, and in such footnote the District Court significantly underlines certain words. The District Court omits the last two paragraphs of Ohio Farmers' Endorsement No. 4 from the part quoted in the footnote to its opinion. This underlining at 140 F. Supp. 439 is here emphasized because it seems to furnish the only indication of why the District Court held that Land was not insured under the policies written by defendants Ohio Farmers and

Lloyd's underwriters; and the question of whether or not Land was so insured is the basic question in this case.

Plaintiff Canadian moved for a new trial in the District Court, R. 59. The motion was heard by the District Court on July 26, 1956, and excerpts from the reporter's transcript of arguments by counsel appear at R. 65-66. It is significant that Mr. Walcom, the attorney retained by Ohio Farmers all through these proceedings to represent that company in the Federal Court action and to represent the employees Land and Correia in the Superior Court action, said in open court, concerning whether or not a proper request in writing to defend the employees had been made under the Ohio Farmers' policy, "But it is a false issue in that we admit that we defended Land and Correia." The brief statement made at that time on behalf of Canadian by the writer of this brief, concerning that request in writing to Ohio Farmers to defend the employees, is reprinted at R. 66.

The District Court denied the motion for a new trial in a minute order dated July 26, 1956, R. 60.

From the judgment based upon the District Court's opinion, findings and conclusions, this appeal is taken.

QUESTIONS PRESENTED.

(1) Are Defendants-Appellees Ohio Farmers and Lloyd's underwriters obligated under their policies

to satisfy the judgment assessed against Clifton Land in the Superior Court action?

(2) As between Louis Stores, Inc., on the one hand, and Clifton Land, on the other hand, which, if either of the two of them (and therefore which insurers), bears the ultimate responsibility to satisfy the Superior Court judgment rendered in favor of Mrs. Christensen?

SPECIFICATION OF ERRORS.

(1) The District Court erred in its finding of fact No. IV (R. 50). The record in the Superior Court case had no evidence sufficient to support verdict and judgment against Louis Stores, Inc., upon the basis of "independent negligence."

(2) The District Court erred in its finding of fact No. VI (R. 51) when it says, at R. 53, concerning the Ohio Farmers' policy, "said policy did not insure Clifton Land."

(3) The District Court erred in its finding of fact No. VIII, at R. 54, when it said, concerning the policy issued by defendant Lloyd's underwriters, "said policy did not insure Clifton Land."

(4) The District Court erred in its conclusions of law Nos. I, II, IV and VI, which are based upon its findings of fact.

(5) The District Court erred in failing to find that the primary liability falls upon the active tort-feasor Clifton Land and his insurers.

ARGUMENT.**I.**

DEFENDANTS-APPELLEES ARE OBLIGATED UNDER THEIR POLICIES TO PAY THE LIABILITY IMPOSED UPON CLIFTON LAND IN FAVOR OF MRS. CHRISTENSEN BY THE SUPERIOR COURT JUDGMENT.

Endorsement No. 4 annexed to the Ohio Farmers' policy is a typewritten endorsement, as distinguished from a printed form. It was prepared specifically for this particular policy. It contains five paragraphs and is set forth in full as part of the District Court's finding No. VI, at R. 51-53. Only three of the five paragraphs are quoted by the District Court in the footnote to its opinion at 140 F. Supp. 439; it is submitted, however, that the document must be considered as a whole and that no part of it may be disregarded. It is submitted, furthermore, that each paragraph thereof must be given some meaning and that in any case of doubt or ambiguity, it must be construed against Ohio Farmers Indemnity Company, which drafted it, and in favor of coverage.

As a preliminary matter, it seems clear that the endorsement is an integral part of the policy and part of the contract of insurance:

Burch v. Hartford Fire Ins. Co., 85 Cal. App. 542, 259 P. 1108;

Jew Fun Him v. Occidental Life Ins. Co., 88 Cal. App. (2d) 246, 198 P. (2d) 711.

Section 380, Insurance Code of California, defines a policy as follows:

“The written instrument, in which a contract of insurance is set forth, is the policy.”

As hereinabove stated, Endorsement 4 is typewritten, whereas the bulk of Ohio Farmers' policy is printed. Attention is respectfully directed to Civil Code 1651, reading as follows:

“Where a contract is partly written and partly printed, or where part of it is written or printed under the special directions of the parties, and with a special view to their intention, and the remainder is copied from a form originally prepared without special reference to the particular parties and the particular contract in question, the written parts control the printed parts, and the parts which are purely original control those which are copied from a form. And if the two are absolutely repugnant, the latter must be so far disregarded.”

Attention is also directed to Civil Code 1654, reading as follows:

“In cases of uncertainty not removed by the preceding rules, the language of a contract should be interpreted most strongly against the party who caused the uncertainty to exist. The promisor is presumed to be such party; except in a contract between a public officer or body, as such, and a private party, in which it is presumed that all uncertainty was caused by the private party.”

The first paragraph of Ohio Farmers' Endorsement 4 says that *the company will defend certain suits on behalf of employees, if and when requested in writing to do so by the named insured*. That condition has been met in the case at bar. The named insured was Louis Stores, Inc. The named insured did request

Ohio Farmers, in writing, to defend the three employees sued in the Superior Court action. The writing appears as Exhibit "B" attached to plaintiff's request for admissions under Rule 36. Exhibit "B" is a copy of a registered letter, dated February 15, 1955, sent to Ohio Farmers by the attorney for Louis Stores, Inc., making specific demand under that endorsement that the defense be undertaken.

Ohio Farmers did undertake the defense of the employees, pursuant to said request in writing, as indicated by paragraph 4 of plaintiff's request for admissions. It has been stipulated that all facts contained in the request for admissions are true. It is here reiterated that Mr. Walcom, himself, in open court, described as "a false issue" any suggestion that the request in writing to defend did not come from the named insured, merely because the request was signed by the attorney representing the named insured in the accident case.

Referring to the additional language in the first paragraph of said Endorsement 4, the named insured was joined with the employees in such suit, and the suit was one which the company was obligated to defend under its policy.

Paragraph two of Endorsement 4 says that the company will pay any loss by liability imposed upon the said employees by final judgment in any *such suit*. It is here submitted that the Alameda County Superior Court action was such a suit, for the reasons just mentioned:

(a) The named insured did request the company in writing to defend on behalf of the employees;

(b) The suit did allege bodily injury covered by the policy;

(c) The named insured was joined as defendant; and

(d) The suit was one which the company was obligated to defend on behalf of the named insured under the policy.

Section 23, California Insurance Code, contains a definition basic to any question of insurance. It reads as follows:

“*‘Insurer’ and ‘insured.’* The person who undertakes to indemnify another by insurance is the insurer, and the person indemnified is the insured.”

It is submitted that nothing could be more clear than that Ohio Farmers, by paragraph 2 of said endorsement, has made the employees of Louis Stores, Inc., “persons indemnified,” as that term is used in the statutory definition of Insurance Code Section 23, for the reason that undertaking to indemnify another, on the one hand, and paying any loss by liability imposed by final judgment, on the other hand, are identical in meaning. Even if there were any doubt, it is a fundamental principle of construing insurance policies that any doubt or ambiguity must be resolved against the insurance company which drafted the policy.

The fourth paragraph of Endorsement 4 says that the company will provide no coverage except where the act of the employee was committed in good faith and was within the scope of employment. It was admitted by all answers in the Superior Court pleading that the employees, especially Land, were acting within the scope of employment. There is no evidence that the alleged acts were committed in bad faith. Hence, paragraph four of Endorsement 4 means by necessary implication that the company does provide coverage in this case.

Paragraph five of Endorsement 4 says that the *insurance provided by the endorsement* shall be in excess over any *other* valid and collectible insurance available to any employee of the named insured. This language denotes by necessary implication that the endorsement *does* provide insurance because, otherwise, paragraph five of the endorsement would make no sense. (Emphasis supplied.)

Paragraph three of the Endorsement says that no privity in contract is created between the company and the employees. It is submitted that the endorsement may not be interpreted in the light of paragraph three alone. Paragraph three must read in conjunction with the other four paragraphs and all must be given meaning, if possible. It is here suggested that paragraph three of the endorsement means that an employee has no right, acting on his own, to require the company to defend him and pay any judgment rendered against him, in the absence of the conditions enumerated in the first paragraph of

said endorsement. It is submitted, however, that once the conditions stated in paragraph one are met, and once the company does so defend, that the employees defended thereupon do become insureds; for, if such employees do not then become insureds, paragraphs two, four and five are rendered meaningless.

(The precise language of paragraph three of Endorsement 4 should be noted: It reads in part, “. . . nor shall this *paragraph* confer any rights upon said employees which said employees would not have had if this *paragraph* had not been written.” (Emphasis supplied.) As a technical matter, paragraph three conferred no rights at all upon the employees which they would not have had if paragraph three had not been written and, therefore, the clause seems wholly senseless. What was probably meant is “endorsement” instead of “paragraph.” That *paragraph*, however, does not purport to confer any “rights” upon anyone. But whether or not any “rights” are conferred, and whether or not the defendant Ohio Farmers chooses to describe the relationship with the words “privity of contract” or not, the fact remains that by paragraph two it has contracted to pay any loss by liability imposed upon employees by final judgment, and the fact remains that by paragraph four it has agreed to provide coverage for an act in good faith within the scope of employment, and the fact remains that in paragraph five the insurance provided by this endorsement is described as excess insurance over any other valid and collectible insurance available to any employee.)

In this connection, attention is directed to Williston on Contracts, Section 619, reading:

“The court will if possible give effect to all parts of the instrument and a construction which gives a reasonable meaning to all its provisions will be preferred to one which leaves a portion of the writing useless or inexplicable; and if this is impossible a construction which gives effect to the main apparent purpose of the contract will be favored.”

It is also respectfully suggested that paragraph three of the endorsement is a recital of law, stating the company's conclusions concerning privity of contract. Paragraphs one, two, four and five, however, are operative parts of the contract, not recitals; they state what the company will do or will not do, as contrasted with a recitation of the company's conclusions of legal status. In this connection, plaintiff-appellant wishes to direct the court's attention to this language in Note 98 at II Williston on Contracts, 1201:

“If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. If the recitals are ambiguous and the operative part is clear, the operative part must prevail. If both the recitals and the operative part are clear, but they are inconsistent with each other, the operative part is to be preferred.”

The State Supreme Court has very recently handed down its decision in *Continental Casualty Co. v. Phoenix Construction Co., Underwriters at Lloyd's, London, et al.*, 46 Cal. (2d) 423, 296 P. (2d) 801. This opinion reads, at 437:

“It is elementary in insurance law that any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer.”

At pages 437-438, the court says:

“If the insurer uses language which is uncertain any reasonable doubt will be resolved against it; if the doubt relates to extent or fact of coverage, whether as to peril insured against . . ., the amount of liability . . ., or the person or persons protected . . ., the language will be understood in its most inclusive sense, for the benefit of the insured.”

Many citations are given.

As the Supreme Court of California says, at page 431 of the opinion cited:

“... if there is a conflict in meaning between an endorsement and the body of the policy, the endorsement controls. . . . Likewise, under the provisions of section 1651 of the Civil Code, the written or specially prepared portions of the contract control over those which are printed or taken from a form. The provisions of the two endorsements, as quoted above, are typewritten, while, as already mentioned, the insuring agreements are part of the printed policy form.”

It is reiterated that the typewritten Endorsement number 4 should take precedence over any seeming inconsistency in the body of the Ohio Farmers' policy which is a printed form.

At page 439, the Supreme Court discusses the provisions of a Lloyd's policy similar to the Lloyd's

policy in the case at bar, and concludes that it increases the protection of an insured under the primary policy, by virtue of having the same warranties, terms and conditions. Hence, it is submitted that if Ohio Farmers is obligated to pay the liability imposed upon Land by final judgment in the Superior Court suit, the Lloyd's underwriters are similarly obligated. It is also reiterated that under Endorsement No. 3 to the Lloyd's policy, appearing at R. 20, Lloyd's obligated itself to protect as an assured any individual, firm or corporation whom the named insured has contracted to protect.

The preconditions of paragraph one of the endorsement have been met, as admitted in plaintiff's request for admissions. The Ohio Farmers Indemnity Company did defend, pursuant to written request by the named insured. The operative parts of that endorsement, as contrasted with the one recital, all indicate that Land is an insured in this case. The typewritten endorsement takes precedence over the printed form of the policy. Any ambiguity must be resolved against the company which drafted the form and in favor of coverage. Paragraphs two, four and five of the endorsement must have some meaning. A logical meaning has been suggested for paragraph three which harmonizes it with all other provisions of the policy.

In the opinion of the District Court at 140 F. Supp. 439, the first three paragraphs of Endorsement 4 are printed in the footnote with certain words underlined. In paragraph one of the endorsement, the Court underscored the words "if and when requested in

writing to do so by the named insured . . .” In paragraph two of the endorsement, the Court underscored the words “such suit,” which refer back to a suit which the named insured has requested the company in writing to defend. Since the use of underlining is the only indication furnished by the District Court as to its reasons for holding that Endorsement 4 does not impose upon defendants-appellees the obligation to pay Land’s liability, it may be inferred that the District Court felt the named insured had not requested Ohio Farmers in writing to defend in the name and on behalf of its employees. It is clear, however, that a registered letter was sent to Ohio Farmers by the attorney representing the named insured in the very accident suit involved; and that letter made specific request, under the specific endorsement, that the defense of the employees be undertaken. It is also clear that Ohio Farmers did undertake the defense pursuant to that request. Even Mr. Walcom, attorney for defendant-appellee Ohio Farmers, said in open court concerning this subject: “But it is a false issue in that we admit that we defended Land and Correia.” R. 66.

II.

AS BETWEEN LOUIS STORES, INC. AND CLIFTON LAND, CLIFTON LAND (AND HIS INSURERS) IS PRIMARILY OBLIGATED TO SATISFY THE SUPERIOR COURT JUDGMENT.

- A. An employer which becomes liable as a result of respondeat superior for an employee's negligence is entitled to reimbursement from the employee.**

This proposition has become so well established in our law as to need little discussion. It has been stated most recently in *Continental Casualty Co. v. Phoenix Construction Co., et al.*, 46 Cal. (2d) 423, at 429.

It has been forcefully stated by this Court in *Canadian Indemnity Co. v. U. S. F. & G.*, 213 F. (2d) 658, affirming *U. S. F. & G. v. Canadian Indemnity Co.*, 107 F. Supp. 683. These cases and the precedents therein cited are clear to the effect that an employer or the employer's insurance carrier may recoup any loss sustained from the negligent employee and the employee's insurance carrier, the latter being primarily liable.

- B. Judgment against Louis Stores, Inc. in the Superior Court must have been based upon respondeat superior for the negligent act of Clifton Land.**

The gravamen of the charge of negligence upon which the Superior Court suit was based is contained in paragraph VIII of the first amended complaint filed in that suit, R. 35. It alleges that the defendants and each of them “. . . so carelessly and negligently operated, maintained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said

grocery department in such manner so as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery department thereof lawfully using said aisle.”

It is clear from the pleadings and the stipulations, as well as from the testimony, that Clifton Land was an employee of Louis Stores, Inc., and was at all relevant times acting in the course of his employment. It is also clear that it was Clifton Land who deliberately caused and permitted the cardboard carton in question to remain in the aisle of the grocery store a short time before plaintiff tripped over it, whereas all the aisles had been cleared shortly before this accident happened. It is also clear from the testimony of Correia that Land had been instructed not to do this but to finish stocking all the contents from any one box, which he caused to be brought out of the storeroom, and then to remove the box from the aisle. It is also clear from the testimony that it would have taken Land only a few seconds longer to remove the other five bottles of Alhambra water remaining in the box and take the box out of the aisle. It has been admitted that the court instructed the jury that if they found Land negligent, they must also find Louis Stores, Inc., liable, because of *respondeat superior*.

Based on these allegations and these facts, what conceivable theory could support liability on the part of Louis Stores, Inc., other than *respondeat superior* for the negligence of Land? Directly applicable to this case is the language of the court in *Pleasant Val-*

ley Association v. Cal-Farm Insurance Co., 142 Cal. App. (2d) 126, 298 P. (2d) 136. In that case, defendant contended that there was some independent negligence on the part of the corporation Pleasant Valley Association. The court pointed out, however, that a corporation may act only through persons. After outlining the acts of negligence which that case involved, the court said:

“All these were acts which Pleasant Valley could only perform through its agents and employes, and it was stipulated at the trial that the wooden blocks had been placed by Croker. The complaint in the Nungaray action and the stipulation of facts in this action are silent as to any acts or omissions on the part of Pleasant Valley other than those of Croker. The complaint alleges that Nungaray drove the truck onto the platform at Croker’s direction, and that Croker was in charge of the elevating machinery. Reading the Nungaray complaint as a whole, we are of the opinion that Pleasant Valley’s negligence is therein predicated upon the negligence of Croker, and that it does not allege separate, concurring negligence on Pleasant Valley’s part.”

Similarly, in the situation at bar, causing and permitting a cardboard carton to be in the aisle were acts which Louis Stores, Inc., could only perform through people; and in this case the proof showed that it was specifically through Clifton Land. He caused and permitted the carton to be exactly where Mrs. Christensen tripped over it. As the court said in *Gardner v. Jonathan Club*, 35 Cal. (2d) 343, 217

P. (2d) 961, "since defendant is a corporation, it can act only through its employees."

In the case at bar, Correia and Land were the only two employees sued, and the complete transcript of their testimony was placed in evidence before the District Court. No suggestion of any misconduct on the part of the corporation, other than the acts of these two employees, was ever made in the Superior Court; and no evidence of any such acts of "independent negligence" was placed before the District Court by defendants-appellees.

The District Court, in its opinion at 140 F. Supp. 439, expresses the view that Louis Stores, Inc., may have been held liable on some other basis than *respondeat superior*. The District Court said, "The jury may have found Louis Stores, Inc., negligent in not providing enough employees, or in not properly instructing its employees what to do. There was enough evidence on which to base such a finding . . ."

It is submitted that in this statement the District Court errs, *in view of the fact that the jury exonerated Correia*. For it was Correia who, as manager of the store, decided how many employees should be placed on duty at any one time, including this particular evening; and it was Correia who instructed the employees what to do. Attention is earnestly directed to the testimony of Correia, complete transcript of which was placed in evidence before the District Court. At page 3, it is clear that Correia was the manager of the store in question and the one in charge of the

premises. No one superior to Correia in the corporation was present in the store, except for periodic visits, and Correia was the one in charge. Correia knew that a single low box in the aisle, below eye level, could be a hazard to safety *and, he had been told that repeatedly by his supervisor*, testimony of Correia, page 6. Correia inspected the aisle before going home, shortly before this accident, and the aisle was clear, testimony of Correia, page 7.

Correia made the decision as to how many employees should be there that particular night, testimony of Correia, page 9. Correia's instructions to Land were that if he had a box in the aisle, he was to stock the shelf he was working on until he had the box empty and then get the box out of the aisle, testimony of Correia, 10:13-19.

It is submitted that the verdict in favor of Correia, the store manager, negatives the suggestions made by the District Court concerning the two possible bases of liability on the part of Louis Stores, Inc., other than *respondeat superior* for the negligence of Land. If Louis Stores failed to provide enough employees, or if it failed properly to instruct its employees, it must have perpetrated such failures through the person of Correia; for he was the store manager and the one who did the acts of deciding how many employees there would be and of instructing Clifton Land. The verdict exonerating Correia, however, must mean that Louis Stores, Inc., was not negligent in these respects. The sole act of negligence shown by

the evidence was the negligence of Clifton Land. His was the only act of negligence alleged by the pleadings in the Superior Court action. Opposing counsel have failed to show the trial court any other act on the part of this corporation, consistent with the evidence and the pleadings, which could possibly form the basis of the judgment against it.

C. In addition to the arguments heretofore made, the only active negligence in this case was that of Clifton Land and hence the ultimate liability falls on him and his insurers.

From the evidence adduced in the Superior Court case and from the verdict, the jury clearly found that Clifton Land was negligent and that his negligence was the proximate cause of Mrs. Christensen's accident.

To hypothesize a different case, it is conceivable that had Louis Stores, Inc., been the only defendant sued, as the result of the customer's having tripped over a box in the aisle, verdict and judgment would have gone against Louis Stores, Inc., alone, on the ground that a corporation operating grocery stores is under duty to the public at all times to keep the aisles clear, even though the customer is unable to prove just how the box got into the aisle. The corporation in such case would be negligent toward the injured plaintiff although, as between the corporation and the person who caused the box to be in the aisle, the negligence of the corporation is passive and the negligence of the person is active. A corporation, it is reiterated, may act only through persons.

This Court, speaking through District Judge Hamlin, sitting pro tem. as a Circuit Judge, has recently held that a shipowner held liable to a stevedore injured on board ship may recover over from the stevedoring company whose negligence caused the injury; on the ground that even though the shipowner was negligent, its negligence was passive, and the negligence of the stevedoring company was the active negligence.

American President Lines Ltd. v. Marine Terminals Corp., 234 F. (2d) 753 (rehearing denied).

In the case at bar, it is submitted by analogy that even though Louis Stores, Inc., may be thought to have some liability to Mrs. Christensen in the absence of a suit against Land, nevertheless, where it is shown that the active negligence was that of Land, the passively negligent corporation may recover over from the actively negligent tort-feasor. Concerning his active negligence, there can be no doubt.

CONCLUSION.

The judgment of the District Court should be reversed and the rights of the parties to this proceeding should be declared as follows:

(1) Defendants-appellees are obligated under their respective policies to pay the liability assessed against Clifton Land in the Alameda County Superior Court action;

(2) The liability of Clifton Land and his insurers is primary to that of Louis Stores, Inc., and its insurers.

Dated, San Francisco, California,
February 27, 1957.

Respectfully submitted,

EDWARD A. FRIEND,

Attorney for Appellant.

This Court, speaking through District Judge Hamlin, sitting pro tem. as a Circuit Judge, has recently held that a shipowner held liable to a stevedore injured on board ship may recover over from the stevedoring company whose negligence caused the injury; on the ground that even though the shipowner was negligent, its negligence was passive, and the negligence of the stevedoring company was the active negligence.

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Dated, San Francisco, California,
February 27, 1957.

Respectfully submitted,

EDWARD A. FRIEND,

Attorney for Appellant.

No. 15,335
United States Court of Appeals
For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and
all other underwriters at Lloyd's
London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

BRIEF OF APPELLEE
PRUDENTIAL ASSURANCE COMPANY.

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**United States Court of Appeals
For the Ninth Circuit**

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and
all other underwriters at Lloyd's
London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

**Appeal from the United States District Court for the
Northern District of California,
Southern Division.**

**BRIEF OF APPELLEE
PRUDENTIAL ASSURANCE COMPANY.**

This is an appeal by the Canadian Indemnity Company (plaintiff below) from a judgment in declaratory relief determining the rights, duties and obligations of appellant and appellees Ohio Farmers' Indemnity Company and Prudential Assurance Company under their respective policies of insurance to discharge a judgment against Louis Stores, Inc., the

assured under said policies, in favor of one Virginia Christensen for personal injuries.

STATEMENT OF CASE.

Appellee Prudential Assurance Company, hereafter called Prudential, cannot accept appellant's statement of the case, which refers only to parts of the record and makes conclusions and observations not contained in the record. Appellee Prudential therefore sets forth the following statement of the case:

One Virginia Christensen suffered personal injuries on September 17, 1954, while shopping in a store operated by Louis Stores, Inc. (R. 33).

Appellant Canadian, by its policy No. 25 CPL 1911, insured Louis Stores, Inc. against liability for bodily injuries to a person injured on the premises of said store to a limit of \$100,000.00. Said policy was in effect at the time said Virginia Christensen was injured. Said policy was admitted in evidence in the Court below but has not been made a part of the printed record here (Finding V, R. 50).

Appellee Ohio, by its policy No. CL 7591, also insured Louis Stores, Inc. against such liability to a limit of \$10,000.00 each person. Said policy was also introduced in evidence upon the trial of this action, but only excerpts therefrom are contained in the printed record (Finding VI, R. 51-53).

Appellee Prudential also issued its policy No. EB 32914-C insuring Louis Stores, Inc. against liability for bodily injuries to persons injured on the premises

of said store for a limit of \$40,000.00 each person, excess over the \$10,000.00 limit provided for in Ohio's said policy. Prudential's policy further provides that liability shall attach thereunder only after Ohio, as primary insurer, has paid or has been held liable to pay the sum of \$10,000.00 on behalf of the assured to any one person for personal injuries. The policy is printed in full in the record, pages 10-22.

Shortly after the accident to Virginia Christensen, Canadian, on October 28, 1954, commenced this action against Ohio in declaratory relief, seeking to determine the rights and liabilities of Canadian and Ohio under their respective policies to defend against or pay any liability of Louis Stores, Inc. and its employees as a result of the injuries sustained by said Virginia Christensen. The complaint was later amended to include Prudential as a defendant (R. 3-5).

Thereafter, said Virginia Christensen commenced an action on January 31, 1955, in the Superior Court for Alameda County against Louis Stores, Inc. and others, seeking to recover for the personal injuries suffered in the Louis store on September 17, 1954. The amended complaint in that action alleges that "defendants, and each of them, so carelessly and negligently operated, maintained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner so as to render said aisle dangerous to the passage of customers." (Par. VIII, R. 35).

The Christensen action was tried to a jury, which returned a verdict in favor of Virginia Christensen in the amount of \$35,000.00 against defendants Louis Stores, Inc. and Clifton Land. The jury found in favor of defendant Earl Correia.

The Superior Court instructed the jury that it could return a verdict against defendant Louis Stores, Inc. alone, and not against its employee, Land. The Court also gave the jury five forms of verdict. One of such forms permitted the jury to find in favor of plaintiff Virginia Christensen against defendant Louis Stores, Inc. alone, and to find in favor of its employees, defendants Earl Correia and Clifton Land (Finding III, R. 49-50).

The instructions to the jury and the forms of verdict referred to above were introduced in the Court below as defendants' Exhibits A and B and as plaintiff's Exhibit 3, respectively. However, none of said exhibits has been printed in the record now before this Court.

All of the evidence received in the Superior Court action was not introduced in the trial of this action in the Court below. Appellant merely introduced below the testimony of defendants Earl Correia and Clifton Land. The Court below did not, therefore, have before it all of the evidence presented to the jury in the Superior Court action.

Appellant refers to the testimony in the Superior Court action of Earl Correia and Clifton Land, which was received in evidence in the Court below as plaintiff's Exhibits Nos. 1 and 2 (Brief, pp. 6-7). However, such testimony has not been printed in the record

and hence under Rule 17(6) will not be considered by this Court.

Appellant has not, in any event, fully summarized the testimony of Land and Correia.

Land testified that he was at the check stand checking out customers when he was informed of the accident to Virginia Christensen; he was the only clerk available at that time to check out customers (page 3). He had asked the courtesy boy to bring up a case of Alhambra distilled water when he received a request from a customer for such water; Land was then at the check stand and had a number of customers waiting; the boy put the box in the aisle against the shelf; Land took one bottle out of the case and went back to wait on the customers and was still doing so when he heard of the accident shortly thereafter (pages 6-9). It was not unusual to have a steady stream of customers at the check stand on a Friday night (page 10). Land's duty was to remain at the check stand when he was alone and he had been instructed to remain there by the officials of Louis Stores, Inc. He was also instructed to remain at the check stand and not to put stock on the shelves as long as there were customers checking out. He followed such instructions (pages 11-12).

Correia testified that he was manager of the store, but he received orders from Holmes, the supervisor; the actual operation of the store was based on directives from the "office" and safety instructions were received from the supervisor (page 3). He testified that Friday night was usually busier than the rest of the week and that this particular store had a heavy

patronage for its size (page 8). He left Land and Nolan, the courtesy boy, to handle the store until closing time. The courtesy boy was not allowed to put stock on the shelves (page 9). Correia did not anticipate that the shelves would be stocked during that time and it was not usual to stock shelves with only one clerk on duty (page 10).

None of the testimony of the other witnesses who testified in the Superior Court action was introduced in the trial of this action.

The Court below found that it cannot be determined whether the judgment against Louis Stores, Inc. in the Christensen action was based on independent negligence and/or on the basis of respondeat superior for the acts or omissions of its employee, Clifton Land; that there was sufficient evidence in the record to support a verdict on either basis; that the Superior Court had given instructions and forms of verdict allowing the jury to find against Louis Stores, Inc. on the basis of independent negligence on its part (Findings III and IV, R. 49-50).

The Court further found that the policies of Canadian and Ohio primarily and concurrently insured the liability of Louis Stores, Inc. arising from the Christensen judgment, and that such liability should be pro-rated between said two insurers on the basis of their respective policy limits (Finding VII, R. 53-54).

The Court further found that none of the policies insured Clifton Land; that Prudential's policy was excess to Ohio's policy and did not attach unless and until the limits of Ohio's policy had been exhausted (Findings V, VI, VIII, R. 50, 53, 54).

The Court accordingly concluded that Louis Stores, Inc. and Clifton Land were held jointly liable by the verdict and judgment in the Christensen action; that Clifton Land was not an insured under any of the policies; that Canadian was obligated to pay ten-elevenths of the Christensen judgment and Ohio was obligated to pay the remaining one-eleventh thereof; that Prudential's excess policy did not therefore attach (Conclusions of Law, R. 55-56). Judgment setting forth such respective obligations was entered on the findings of fact and conclusions of law (R. 57).

QUESTIONS PRESENTED.

It is not disputed that Canadian and Ohio concurrently insured the liability of Louis Stores, Inc. arising from the Christensen judgment. Canadian, nevertheless, attempts by the present action to avoid payment of *any part* of the Christensen judgment against Louis Stores, Inc., for which its policy is admittedly liable, and to shift the entire liability onto Ohio and Prudential.

Appellant's statement of the "Questions Presented" is so worded as to emphasize such purpose on the part of Canadian, but does not correctly state the issues on this appeal.

The questions presented are merely whether the following findings and conclusions of the Court below are clearly erroneous:

1. Clifton Land was not an assured under the policies of either Ohio or Prudential.

2. The verdict of the jury in the Christensen action against Louis Stores, Inc. was not based solely upon respondeat superior for the acts or omissions of Land.

It is clear that the judgment below must be affirmed unless *both* such findings are clearly erroneous.

Appellant has made no specification of error as to Findings VII or IX (R. 53-54) or Conclusions of Law III or V (R. 55-56). It is, therefore, admitted that the judgment of the Court below pro-rating the obligation of appellant and Ohio to satisfy the Christensen judgment in the respective proportions of ten-elevenths and one-eleventh is correct if the findings and conclusions referred to above are not both clearly erroneous.

ARGUMENT.

I.

PRUDENTIAL'S POLICY DOES NOT INSURE CLIFTON LAND.

The trial Court found that neither the policy of Ohio nor that of Prudential insured Clifton Land (Finding VI, R. 53; Finding VIII, R. 54). Appellant's first point is apparently intended to attack these findings, but it does not directly do so. Its specifications of error (2) and (3) merely state that the District Court erred in so finding (Appellant's brief, page 9). There is no attempt to state wherein said findings are alleged to be erroneous as required by Rule 18, subdivision 2(d).

It would also appear essential to have the entire policy of Ohio in the printed record, if appellant in-

tends to attack the trial Court's interpretation of the policy. Appellant itself asserts that "the document must be considered as a whole and no part of it may be disregarded" (Brief, page 10). But appellant has printed only brief excerpts from Ohio's policy (R. 1-2, Finding VI, R. 51-53).

It is apparently appellant's contention that Clifton Land was an insured under Ohio's policy and, based on that premise, was also an insured under Prudential's policy. Such argument is based wholly on endorsement No. 4, entitled "Defense of Employees", attached to Ohio's policy (R. 51-53). We believe that a consideration of all the relevant factors involved will demonstrate the correctness of the findings that neither Ohio nor Prudential insured Land.

A. Ohio Did Not Insure Land.

Appellant completely ignores the principal insuring agreements of Ohio's policy and relies wholly on endorsement 4 (Brief, pages 10-19). The trial Court pointed out in its opinion that Ohio's policy provided (R. 44-45):

"Item 1. Name of Insured—Louis Stores, Inc.

* * * * *

Insuring Agreements

III. Definition of Insured.

The unqualified word 'Insured' includes the Named Insured and also includes (1) under Coverages B & D, any partner, executive officer, director or stockholder thereof while acting within the scope of his duties as such * * *."

The coverage of the policy applicable in this instance also provides:

“Coverage B—Bodily Injury Liability—Except Automobile

To pay on behalf of the Insured all sums which the Insured shall become legally obligated to pay as damages because of bodily injury, sickness or disease, including death at any time resulting therefrom, sustained by any person and caused by accident.” (R. 1-2).

The foregoing fundamental provisions of the policy cannot be ignored, and they establish that Land was not an insured named or designated by class, in Ohio’s policy, as pointed out by the trial Court (R. 44).

Endorsement 4 does not, as appellant contends, constitute Land, the employee, an insured under the policy. On the contrary, such endorsement is merely a supplementary agreement between the insurer and the insured, Louis Stores, Inc., wholly for the latter’s benefit. It does not modify, conflict with or render uncertain the provisions of the policy set out above.

Endorsement 4 is significantly entitled “Defense of Employees.” It consists of five provisions. Appellant laboriously analyzes each provision separately, picking on a word here and there, in an endeavor to find some basis upon which to fasten its contention that Land is thereby made an insured.

The first paragraph of endorsement 4 certainly contains no provision constituting any employee an insured (R. 51-52). It merely provides that Ohio will defend employees of the named insured in certain types of suits at the request of the named insured. Such provision is clearly for the benefit of the named insured who is the *only* one who can enforce it.

Appellant states again and again in its brief that the insured did request Ohio to defend the three employees sued in the Christensen action (Brief, pages 4, 8, 11, 18, 19). This matter seems to give appellant particular concern and it apparently hopes that its statement will gain strength by repetition. The facts are simply that the attorney retained by appellant to defend Louis Stores, Inc., wrote a letter to Ohio demanding that Ohio defend the three employees in the Christensen action. (Demand for admissions, pars. 3, 6, Exhibit B, R. 23-24, 31.) Ohio did defend the employees. Such evidence shows a request by *appellant*, not by the named *insured*, to defend the employees. There is no evidence in the record that appellant's attorney had any authority to make such request on behalf of Louis Stores, Inc.

Paragraph 2 of the endorsement provides that Ohio will also pay, within policy limits, loss by liability imposed upon said employees by final judgment in the types of suit specified in the first paragraph (R. 52). Since the defense of such suits is wholly in the control of the named assured as provided in the first paragraph, it is clear that paragraph 2 is also wholly for the benefit of the named assured, who alone can enforce such provisions. The employee merely receives the benefit of free defense at the request of the named insured and payment of a judgment against, or which could have been rendered against, the named insured.

Appellant refers to section 23, *California Insurance Code*, to support its contention. The definition therein set forth refers to indemnity by *insurance*, not to any type of indemnity. The insurance provided by Ohio's

policy is, however, a contract with Louis Stores, Inc., not with any employee.

Transportation Guarantee Co. v. Jellins, 29 Cal. 2d 242, 174 P. 2d 625.

Paragraph 3 provides that it is understood and agreed that the policy is a contract between Ohio and the named insured and that nothing therein shall be construed as creating any privity of contract between Ohio and any employee of the named insured, and that no rights are conferred on any employee which said employee would not have had if this paragraph (endorsement) had not been written.

Appellant states that paragraph 3 is a recital of law whereas the other four paragraphs are operative. Paragraph 3 is, however, an express, contractual provision of the endorsement and clearly sets forth the intent and effect of the endorsement.

Paragraph 4 merely provides that Ohio will provide no coverage except where the act of the employee is committed in good faith and is within the scope of employment (R. 52). Appellant states that by necessary implication the company does provide coverage in this case (Brief, page 14). There is no necessity for implication. The policy, as seen from paragraphs 1, 2 and 3 of the endorsement, does expressly provide coverage but such coverage is for Louis Stores, Inc. only.

Paragraph 5 states that the insurance provided by endorsement 4 shall be excess insurance over any other valid, collectible insurance available to any employee of the named insured (R. 53). Again, plaintiff states that by necessary implication the endorsement does

provide insurance because, otherwise, paragraph 5 would make no sense. As stated above, the endorsement does expressly provide insurance for Louis Stores, Inc. Paragraph 5 does make sense because the endorsement would provide only excess insurance to Louis Stores, Inc. if it had another policy containing the same coverage. The policy, however, is a contract only between Ohio and Louis Stores, Inc.

Appellant cites authorities to the effect that any ambiguity in a policy of insurance must be resolved against the insurer (Brief, pages 10, 13, 17, 18). The rule has not been fully stated by appellant. It applies only between the insurer and the insured, which, in this instance, is Louis Stores, Inc. The rule has no application at all in favor of a complete stranger, such as appellant, to the policy. Likewise the rule has no application if the insured is responsible for the language used.

Thus, in *American Lumbermen's Mutual Casualty Co. v. Trask*, 266 N.Y.S. 1 (affirmed 191 N.E. 557), an action between the insurer and a stranger to the policy, the Court said:

“The rule of strict construction against the insurance company is not, however, applicable in favor of the defendant. The plaintiff is here seeking to enforce its right as against a stranger to the contract.”

In *Nieschlag & Co. v. Atlantic Mutual Insurance Co.*, 43 F. Supp. 797, 799 (affirmed 126 F. 2d 834 (2 C.A.A.)), the Court said:

“* * * In addition the plaintiff itself insisted upon the form used. For these reasons, the prin-

ciple that the form should be construed most strongly against the insurer should be held inapplicable.”

On the contrary, if there is any doubt or ambiguity in the endorsement, such doubt must be resolved against appellant, a stranger to the contract. For, as said in *Chamberlin v. City of Los Angeles*, 92 Cal. App. 2d 330, 332, 206 P. 2d 662:

“An intent to make an obligation inure to the benefit of a third party must clearly appear in a contract of insurance and if any doubt exists it should be construed against such intent.”

The statement of the California Supreme Court in *Transportation Guarantee Co. v. Jellins*, 29 Cal. 2d 242, 245, 174 P. 2d 625, 627, is also peculiarly appropriate here, since appellant, a stranger to the policy, also contends that Land, another stranger thereto, becomes an insured:

“Certain language in the contracts, which seemingly is inconsistent with other provisions thereof, is pointed to by defendant as constituting what he claims to be ‘insuring clauses.’ Contending that the language of these clauses *can* be construed to constitute an insurance obligation it is urged that it *should* be so construed because ‘If there is any ambiguity (in an insurance contract) it is to be construed most strongly against the insurer.’ This argument is entitled to no weight since it seeks to persuade that plaintiff *is* an insurer by applying the rule that would be applicable *only if it were one*.” (Court’s emphasis.)

But, while appellant mentions rules of law referring to ambiguity, it utterly fails to point out any am-

biguity in the language of endorsement 4. There is, then, no ambiguity or uncertainty in the language to be *interpreted* in favor of anyone. Likewise, there is no inconsistency between the endorsement and the definition of insured and the insuring agreements in the body of the policy. Clifton Land, the insured's employee, is clearly not an insured under either the "Definition of Insured" or under the endorsement.

Therefore, as stated in *Continental Casualty Co. v. Phoenix Construction Co.*, 46 Cal. 2d 423, 432, 296 P. 2d 801, 806:

"An insurance company has the right to limit the coverage of a policy issued by it and when it has done so, the plain language of the limitation must be respected."

Appellant also contends that all five paragraphs of endorsement 4 must be given effect and that operative parts of the endorsement govern recitals. Such contention presents no problem here. The construction given to the endorsement by the Court below does give effect to the entire endorsement. There is no conflict among the five paragraphs thereof. The Court found that none of the paragraphs states or implies that Land is an assured (R. 44-46). Paragraphs 1 and 2 are, by their express language, for the benefit only of the named insured, Louis Stores, Inc. Paragraphs 4 and 5 refer again only to the coverage of Louis Stores, Inc., since they refer to the coverage provided in paragraphs 1 and 2. Furthermore, paragraphs 4 and 5 are not involved on the facts of this case. To avoid even the possibility of anyone making appellant's present contention, paragraph 3 expressly and clearly provides

that there is no privity of contract between Ohio and any employee of Louis Stores, Inc.

Appellant does not, of course, contend that paragraphs 1, 2, 4 and 5 expressly provide that an employee of Louis Stores, Inc. is an insured. It contends that the endorsement as a whole should be so *construed*. On the other hand, paragraph 3 expressly provides that the endorsement shall *not* be so construed. Appellant states that paragraph 3 is a recital. It is, however, an express, clear, contractual provision between the parties and must be given effect.

Appellant's contention, therefore, is simply this: Paragraphs 1, 2, 4 and 5 are not free from doubt and should be construed against Ohio in favor of appellant, a complete stranger to the contract. Paragraph 3 is clear but is a recital.

Such contention is wholly refuted by appellant's own quotation from II *Williston on Contracts*, page 1201, note 98, as follows (Brief, page 16) :

“If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. * * *”

Appellant's requested construction of the endorsement would not only give it a meaning not found in the language thereof, but would also ignore completely the clear, express provisions of paragraph 3. The authorities cited by appellant itself show the impropriety of such construction.

Appellant states that the underlining by the Court below in its opinion of the words “if and when requested in writing to do so by the named insured” in

the first paragraph of endorsement 4 is the only indication by the Court as to its reasons for holding that endorsement 4 does not make Land an insured under Ohio's policy (Brief, pages 18-19). Appellant is quite mistaken. The trial Court clearly stated its reasons to the effect that neither the language of the policy proper nor of the endorsement made Land an insured or gave him the right to enforce it (R. 44-46).

If it may be inferred from the Court's underlining of parts of paragraphs 1 and 2 that it found that the named insured did not request Ohio in writing to defend the insured's employees, such finding would be strictly in accord with the facts. Louis Stores, Inc. did not request in writing Ohio to defend the employees. Appellant's attorney made such request.

Appellant makes a suggestion and admission as to the effect of endorsement 4 which not merely shows the fallacy of its contention that Ohio insured Land, but which is fatal to such contention.

Canadian suggests that paragraph 3 of endorsement 4 means that an employee has no right, acting on his own, to require Ohio to defend him or pay any judgment against him unless and until the conditions of paragraph 1 are met. But, it states, once such conditions are met, the employees *then* become insureds (Brief, pages 14-15).

It is, of course, obvious that the conditions of paragraph 1 of the endorsement cannot be met until *after* the insured event has occurred and is known. The Christensen accident was certainly known to both

Louis Stores, Inc. and Land before the Christensen action was filed. If Land was not an insured under Ohio's policy before the accident, as appellant concedes, then Land could not become an insured after the accident had not only occurred but was known to have occurred. For, as stated in *Vyn v. Northwest Casualty Co.*, 47 A.C. 84, 89, 301 P.2d 869, 872:

“Clearly, under plaintiff's theory there would not be an insurance contract, under the facts here presented, because the contingency was known to both plaintiff and Norwich when the premium was paid. ‘Insurance is a contract whereby one undertakes to indemnify another against loss, damage or liability arising from a contingent or unknown event.’ (Ins. Code, Sec. 22.) ‘Except as provided in this article any contingent or unknown event, whether past or future, which may damage or create a liability against him, may be insured against, subject to the provisions of this code.’ (*Id.*, Sec. 250.) The exceptions refer to lotteries, gaming and wagering (*id.*, Secs. 251-252).”

Land could not, under the provisions of the California Insurance Code quoted above, become an insured under Ohio's policy *after* the event (the Christensen accident) was neither contingent nor unknown.

The trial Court's finding that Ohio's policy does not insure Land is, therefore, manifestly correct.

B. Prudential Did Not Insure Land.

The trial Court also found that the Prudential policy, which is only an excess policy, does not insure

Land (Finding VIII, R. 54). The Prudential policy does not contain any provisions of the nature of endorsement 4 in Ohio's policy (R. 10). Appellant's contention that such endorsement makes Land an insured under Ohio's policy after the known loss is not, therefore, in any event, applicable to Prudential's policy.

Appellant states that if Ohio is obligated to pay Land's liability under the Christensen judgment, Prudential is similarly obligated by virtue of having the same warranties, terms and conditions in its policy. The statement is not accurate as to the terms of Prudential's policy, and appellant's conclusion does not follow. It is made without argument or elaboration, and we trust that appellant is not holding back any argument for its reply brief.

No employee of Louis Stores is insured under Prudential's policy for a number of reasons.

1. The policy names Louis Stores, Inc. and no one else as the insured (R. 10). The policy contains no provision giving automatic coverage to any other person or persons.

Section 387, California Insurance Code, provides:

"When the name of the person intended to be insured is specified in a policy, it can be applied only to his own interest."

In referring to Section 387 of the Insurance Code, formerly Section 2588 of the Civil Code, the Court said in *Van DerHoof v. Chambon*, 121 Cal. App. 118, 128, 8 P.2d 925, 929:

“It will be seen from an examination of the policy that it insures Gus Chambon and no other person. The name of the person is inserted in the policy and under section 2588 of the Civil Code it can be applied only to his own proper interest.”

The Prudential policy names only Louis Stores, Inc. as the insured and does not refer to the assureds or assureds named or provided for in the underlying Ohio policy. On the contrary, the policy specifically names the assured and refers only to the “hazards” covered by the underlying policy (R. 10, 13).

The rule is well established that an insurance policy insures only the persons named or designated in the policy and cannot be held to include unnamed persons by inference or by doubtful provisions.

Willamette Nav. Co. v. Hartford Fire Ins. Co.,
287 Fed. 464, 467 (9 C.C.A.)

Klefsstad v. American Cent. Ins. Co., 207 F. 2d
288, 289-290 (7 C.C.A.)

National Auto. Ins. Co. v. I. A. C., 11 C. 2d 694,
697, 81 P. 2d 928, 930;

Chamberlin v. City of Los Angeles, 92 C.A. 2d
330, 332; 206 P. 2d 661, 662.

2. Appellant apparently relies upon Condition 5 of the Prudential policy to claim that if Land is an assured under Ohio's policy, he is also an assured under Prudential's policy by virtue of Condition 5 in the latter policy, which reads (R. 16):

“5. Maintenance of Primary Insurance. This Certificate is subject to the same warranties,

terms and conditions (*except* as regards the premium, *the obligation to investigate and defend*, the amount and limits of liability and the renewal agreement, if any, and *except as otherwise provided* herein) as are contained in or as may be added to the policy/ies of the Primary Insurers prior to the happening of an accident for which claim is made hereunder and should any alteration be made in the premium for the policy/ies of the Primary Insurers during the currency of this Certificate, then the premium hereon shall be adjusted accordingly." (Emphasis ours).

We think that it is obvious that a reference to the warranties, terms and conditions of the primary policy does not include the designation or name of the assured or the naming of an additional assured, particularly when the Prudential policy expressly states that the insurance is bound in favor of Louis Stores, Inc.

The name or designation of the assured is clearly not a warranty. A warranty is a stipulation of fact or promised line of conduct *by* the assured set forth in the policy on the literal truth or fulfillment of which the validity of the entire contract depends.

California Insurance Code, sections 441, 444;

McKenzie v. Scottish U. & N. Ins. Co., 112 Cal. 548, 554; 44 P. 922, 924;

Gise v. Fidelity & Casualty Co., 188 Cal. 429, 433; 206 P. 624, 626.

Thus, the insured may warrant that he has never had heart disease, or that he will maintain a watchman on the insured property. Warranties are fre-

quently referred to as conditions precedent or subsequent, breach of which avoids the policy. However, there may be other conditions which are not warranties, but which restrict or limit the coverage of the policy, or even avoid it. Thus, it may be a condition of the insurance that it will be void if the assured procures other insurance, or fails to pay the premium, or keeps explosives on the premises. To be more specific, the Ohio policy sets forth 19 clauses designated "Conditions", none of which contains any provision as to who is or may become the insured.

It is equally clear that the reference to the "terms" of the primary policy refers to the hazards insured against, such as bodily injury, property damage, and to the limitations and restrictions thereon, and not to the person or persons insured. Thus, the Prudential policy states that it insures Louis Stores, Inc., "subject to the terms, conditions and limitations hereinafter mentioned." The persons insured in Prudential's policy are not, therefore, determined or affected by the reference to part of the "warranties, terms and conditions" of the underlying policy.

In the Court below, appellant argued that Prudential, having issued an excess policy naming Ohio's policy as the primary, underlying policy, could not say that it covered less than the underlying policy. The Prudential policy expressly provides that it covers less than the Ohio policy and there is no reason that it may not so provide.

In *National Auto Insurance Co. v. I.A.C.*, 11 Cal. 2d 689, 691; 81 P.2d 926, 927, the Court said:

“The right of an insurer to limit its contract of coverage may not be questioned.”

The insuring clause of Prudential's policy does expressly limit its coverage to the liability of Louis Stores, Inc. for *personal injuries* arising out of the *hazards* covered by Ohio's policy. Prudential does not cover liability for property damage, costs of defense and other items insured by Ohio (R. 12-13).

3. Condition 5 of the Prudential policy, quoted above pages 20-21, expressly also *excludes* application of the warranties, terms and conditions of Ohio's underlying policy as to the premium, *the obligation to investigate and defend*, the amount and limits of liability and the renewal agreement, if any, and also excludes provisions which are *otherwise provided for in Prudential's policy*.

The very nature of the exceptions thus expressly set forth illustrates the nature of the provisions of Ohio's policy intended by the words “Warranties, terms and conditions.” It is, therefore, clear that such reference does not make endorsement 4, entitled “Defense of Employees”, in Ohio's policy, a part of Prudential's policy. On the contrary, condition 5 of Prudential's policy, quoted above, expressly *excludes* the provisions of endorsement 4 from its excess policy. Any obligation to pay provided for in said endorsement is limited to a judgment in a suit which Ohio is obligated to *defend*. Since Prudential could not have any obligation *to defend* any of the insured's employees, it cannot have any obligation to pay, which is wholly dependent on the obligation to defend. The

interdependent provisions of Ohio's endorsement 4 cannot be segregated to fasten upon Prudential a liability which it has clearly and expressly excluded from its policy. Prudential's coverage of its insured, Louis Stores, Inc. against liability for personal injuries is not, of course, dependent on any obligation to defend.

4. Condition 5 of Prudential's policy also provides that it is subject to warranties, terms and conditions contained in the primary policy "except as otherwise provided herein" (pages 20-21 above). Prudential has not only expressly excluded from its policy Ohio's endorsement 4 ("Defense of Employees") as discussed above, but has by endorsement provided how persons other than the named insured may become insureds in the Prudential policy. Endorsement 3 on the Prudential policy provides that persons with whom the insured (Louis Stores, Inc.) has *contracted* to protect by insurance shall be deemed insureds under Prudential's policy with specified limitations (R. 20-21). Such provision for additional insureds is quite *different* from the "Defense of Employees" endorsement on Ohio's policy. Pursuant to condition 5 of Prudential's policy, it would not be subject to the endorsement on Ohio's policy, but would be subject only to its own endorsement 3 which provides "otherwise" in such respect.

Appellant refers to Prudential's endorsement 3 without explanation (Brief, page 18). We do not know whether appellant thereby hopes to imply that Louis Stores, Inc. contracted with Land to protect him by insurance. The fact is that Louis Stores, Inc. had

not contracted with Land to protect him by insurance and no evidence was offered to show any such contract. The Ohio policy is obviously not a contract between Louis Stores, Inc. and Land.

Brief reference is made by appellant to *Continental Casualty Co. v. Phoenix Construction Co.*, 46 Cal. 2d 423; 296 P. 2d 801, as concluding that an excess policy increases the protection of an insured under a primary policy by having the same warranties, terms and conditions.

The *Continental* case involved different policy provisions and questions from those presented in the present case. The excess policy there expressly named as insureds, (page 439): "Oilfields Trucking Company, *et al.* and other persons . . . named as insureds under said policies, *all hereinafter called the Assured.*" (Our emphasis.) A "condition" of the primary policy incorporated the motor vehicle "Financial Responsibility Laws" of California and under such laws an employee-truck driver was an automatic insured under the primary policy. This is a very different reference to or naming of insureds from that appearing in Prudential's policy in this case. The policy here concerned names only one insured, excludes coverage for "Defense of Employees," and has its own provision for naming any additional insureds.

It is, therefore, respectfully submitted that the findings of the trial Court are correct that Land was not an insured under the policies of either Ohio or Prudential.

II.

**THE VERDICT OF THE JURY IN THE CHRISTENSEN ACTION IS
CONCLUSIVE IN THIS ACTION THAT LOUIS STORES, INC.
WAS HELD LIABLE FOR ITS INDEPENDENT NEGLIGENCE.**

This issue need not, of course, be determined if the finding of the trial Court that Land was not an insured under the policies of either Ohio or Prudential is affirmed. Since, as discussed, Land was not insured under either of those policies, the judgment must be affirmed regardless of whether Louis Stores, Inc. was held liable to Mrs. Christensen on the theory of *respondeat superior* or as a joint tort-feasor. Conversely, the judgment must also be affirmed if Louis Stores, Inc. was guilty of independent negligence, even though Land was an insured in Ohio's policy. For, if Louis Stores, Inc. admittedly insured by both appellant and Ohio, was independently negligent, there can be no question of primary or secondary liability to satisfy the Christensen judgment. Appellant, by this action, sought a full determination on all issues as to the respective liabilities of the parties arising out of the injuries to Mrs. Christensen.

Appellant's specification of error (1) addressed to this contention states that finding IV is erroneous for the reason that the record in the Superior Court case had no evidence sufficient to support a verdict and judgment against Louis Stores, Inc. upon the basis of independent negligence (Brief, page 9). Such alleged error, based wholly on appellant's gratuitous statement, may not be considered at all for two reasons. First, appellant, *who had the burden of proof*,

did not introduce *all* of the evidence in the Superior Court action.

Pacific Portland Cement Co. v. Food Mach. & Chem. Corp., 178 F. 2d 541, 546 (9 C.C.A.).

Second, the verdict and judgment in the Superior Court action are conclusive upon appellant and the issues therein cannot be relitigated in this action.

A. The Verdict and Judgment in the Christensen Action Conclusively Establish in This Action That Louis Stores, Inc. Was Held Liable for Its Independent Negligence.

It is well established that liability insurers, having notice, are conclusively bound by the proceedings, the verdict and judgment in the action brought by the injured person against their insured. This is particularly true, where, as here, appellant actively defended its insured, Louis Stores, Inc. in the Christensen action (R. 24, par. 6).

In *Parra v. Traeger*, 214 Cal. 535, 6 P. 2d 941, an insurer attempted in an action against it by the insured to relitigate the issue as to whether or not a taxicab was being used as such by the driver when it struck and injured a third person who had recovered against the insured in a separate action. The Court said, page 538 (6 P. 2d 941-2):

“The judgment in said action, and its affirmation by this Court upon appeal, determined that issue conclusively, both as against said Parra and his employee Fernandez, the defendants therein, and as against Parra’s insurer, which, in conform-

ity with the terms of its policy, had undertaken the defense of said action and had maintained the same until the final conclusion thereof upon said appeal.”

* * * *

“This Court has uniformly held that where the insurer, upon such indemnifying policy and under its express agreement therein so to do, undertakes, on behalf of its insured, his defense in an action covered by the terms of its said policy, whatever judgment is rendered and entered therein against the assured is binding and conclusive against the insurer.”

The same rule is stated in *Lamb v. Belt Casualty Co.*, 3 Cal. App. 2d 624, 631, 40 P. 2d 311 in a case involving in principle the same question presented here.

This Court has followed the California decisions in applying the same rule:

Ocean Accident & Guarantee Corporation v. Torres, 91 F. 2d 464, 471;

Maryland Casualty Co. v. Lopopolo, 97 F. 2d 554, 556.

It appears from the Superior Court record that the issue which appellant now seeks to litigate was presented and determined in the Christensen action adversely to appellant's present contention. Under the above authorities the Christensen verdict and judgment are conclusive against appellant.

The Christensen amended complaint alleged that “defendants, and *each of them*, so carelessly and negli-

gently operated, maintained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner so as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery department thereof lawfully using said aisle." (Par. VIII, R. 35) (emphasis ours).

The complaint also alleges that said grocery department was operated by Louis Stores, Inc. and that the accident occurred as a direct and proximate result of said carelessness and negligence of defendants and *each of them* (Pars. VI, IX, R. 34, 35).

Said allegations, under California law, clearly plead concurrent negligence on the part of Louis Stores, Inc. and its employees.

Jensen v. Southern Pacific Co., 129 Cal. App. 2d 67, 70, 276 P. 2d 703, 706.

Appellant refers to the case of *Pleasant Valley Association v. Cal-Farm Insurance Co.*, 142 Cal. App. 2d 126, 298 P. 2d 109. The Court there concluded, based on both the complaint and a stipulation of facts, that all of the acts complained of were the undirected acts of the employee. Neither the complaint nor the evidence presented the issues involved in the Christensen action.

In addition to the allegations of the Christensen complaint, the Superior Court gave an instruction to

the jury that they could find a verdict against Louis Stores, Inc. alone and not against its employees. Said Court also gave to the jury a form of verdict to the same effect (Finding III, R. 49-50). Said instruction and form of verdict *conclusively* establish in this action that there was evidence presented to the jury in the Christensen action which would permit a finding of negligence on the part of Louis Stores, Inc. not based solely on *respondeat superior* for the acts of its employees.

For, such instruction and form of verdict would be improper if the liability of Louis Stores, Inc. depended solely on *respondeat superior*. On the other hand, such instruction and form of verdict is proper where the evidence would support a finding of independent negligence on the part of the employer.

Thus, in *Jensen v. Southern Pacific Co.*, 129 Cal. App. 2d 67, 276 P. 2d 703, the Court said, pages 69-70 (276 P. 2d 705-706):

“If the company’s liability, predicated upon negligent operation of the train, rested solely upon *respondeat superior* and not upon its own independent tort, exoneration of the trainmen would have exonerated the company. (*Freeman v. Churchill*, 30 Cal. 2d 453, 461 (183 P. 2d 4), and authorities there cited.)

However, in the instant case, plaintiffs in one of the counts of the complaint, pleaded concurrent liability upon the part of the company and the trainmen. Such allegations presented the possibility of proof of independent negligence upon the part of the company.”

Such rules are well established in California:

Benson v. Southern Pacific Co., 177 Cal. 777, 171 P. 948.

McInerney v. United Railroads, 50 Cal. App. 538, 195 P. 958.

McCullough v. Langer, 23 Cal. App. 2d 510, 516, 73 P. 2d 649, 652.

Newman v. Fox West Coast Theatres, 86 Cal. App. 2d 428, 433, 194 P. 2d 706, 708-709.

In view of the allegations of the amended complaint and the instruction and form of verdict given by the Court in the Christensen action, the general verdict of the jury against Louis Stores, Inc. and its employee, Land, constituted an implied finding of joint liability against said defendants. Such finding is, as discussed above, conclusive in the present action.

Thus, in *Benson v. Southern Pacific Co.*, 177 Cal. 777, 171 P. 948, the jury brought in a verdict against the employer, but made no mention of the employee. The complaint alleged concurrent negligence on the part of employer and employee, although the Court gave the jury an instruction on *respondeat superior*. The Court held, page 780 (171 P. 949):

“* * * All intendments being in favor of the verdict, it must be considered that the jury based the same upon a finding of joint liability, unless there is something in the record which prevents that conclusion.”

Likewise, in *Lamb v. Belt Casualty Co.*, 3 Cal. App. 2d 624, 40 P. 2d 311, it became important to determine for purpose of insurance whether a trailer

as well as its towing truck had been operated negligently. The complaint in the correlative third party action for personal injuries alleged the negligent operation of both truck and trailer. The jury brought in a general verdict in favor of the injured persons. The Court said in the insurance litigation, comparable to the present case (pages 628, 632, 40 P. 2d 313, 314) :

“These complaints allege negligent operation of the truck as well as the trailer, and that negligent operation of both resulted in injuries to the plaintiffs, and a trial was had on these issues. By returning general verdicts awarding damages to the plaintiffs, Davis and Barr, the jury in each case impliedly found that both truck and trailer were at the time of the accident being operated negligently and that the negligent operation of the truck as well as the trailer, contributed proximately to the injuries complained of and to the damage of the plaintiffs in the amounts awarded.

* * * *

“The judgments establish the liability of the insured arising out of the operation of both the truck and the trailer, and are conclusive as against the insurer on each vehicle, but do not express the proportion of the liability which each insurer is obliged to meet.”

A general verdict is, of course, a finding in favor of the prevailing party on all material issues, particularly those covered by instructions.

Appellant is, therefore, conclusively bound by the implied finding of the jury in the Christensen action that Louis Stores, Inc., the employer, was liable for

its independent negligence concurring with that of its employee.

B. The Finding of the Court Below Must Be Affirmed Where the Evidence Is Conflicting or the Record on Appeal Is Incomplete.

The Court below found that it cannot be determined whether the verdict and judgment against Louis Stores, Inc. in the Christensen action was based on its independent negligence and/or on the basis of *respondeat superior* for the acts or omissions of its employee, Clifton Land. The Court further found that there was evidence to support a verdict on either basis (Finding IV, R. 50). Since the appellant (plaintiff below) had the burden to prove its contentions and failed to do so, the Court concluded that Louis Stores, Inc. and its employee, Land, were held jointly liable by the verdict and judgment against them in the Christensen action (Conclusion of Law I, R. 55).

The Court below had before it as evidence the Christensen amended complaint, the verdict of the jury, the Superior Court instructions, the forms of verdict and the testimony of Land and Correia. If this testimony be deemed conflicting on the issue of the independent negligence of Louis Stores, Inc., the finding of the trial Court must be affirmed.

Bolander v. Godsil, 116 F. 2d 437, 439 (9 C.C.A.).

However, it also appears that appellant has failed to print, as required by Rule 17(6), the Superior Court instructions, the forms of verdict and the testi-

mony of Land and Correia. Such evidence, which was before the trial Court, will not be considered by this Court. Hence, the finding of the trial Court, based in part on evidence not before this Court, will be accepted as correct.

Rosenblum v. Anglim, 135 F. 2d 512, 513 (9 C.C.A.).

Tozzi v. Balley, 148 F. 2d 660 (9 C.C.A.).

Finding IV and Conclusion of Law I, therefore, emphasize the conclusive effect of the jury's verdict in the Christensen action that Louis Stores, Inc. was held liable for its independent negligence.

C. The Testimony of Land and Correia Will Not Be Considered on This Appeal.

Appellant relies almost wholly on the testimony of Land and Correia to support its contention that Louis Stores, Inc. was held liable only on the basis of *respondeat superior*. Since such testimony has not been printed, it will not be considered on this appeal. The matter is not, in any event, important in view of the conclusive nature of the verdict against appellant's contention.

However, as found by the trial Court, their evidence does show independent negligence on the part of Louis Stores, Inc. It is clear from their testimony, summarized on pages 5-6 above, that Louis Stores, Inc. could have been found concurrently negligent in: (1) expressly instructing Land to remain at the check

stand when he was alone; (2) instructing him not to put stock on shelves when customers were checking out; (3) failing to instruct the store manager to have more than one clerk on duty at all times to care for the situation which arose on the evening of the accident (4) failing to provide enough employees (Correia assigned the clerks, but he did not hire them); (5) failing to supervise properly the operation of the store.

Benson v. Southern Pacific Co., 177 Cal. 777, 779, 171 P. 948, 959.

Appellant suggests that the exoneration of Correia negatives independent negligence on the part of the employer. Appellant does not correctly summarize Correia's testimony. But, under similar circumstances, it has been properly held that the exoneration of the manager emphasizes the independent negligence of the employer.

In *Newman v. Fox West Coast Theatres*, 86 Cal. App. 2d 428, 194 P. 2d 706, the corporate owner of a theatre was held liable although the manager thereof, who was on duty, was exonerated from liability for personal injuries suffered by a licensee as the result of a mess on the floor of a lavatory. The manager was aware of the condition but had done nothing to remedy it. The situation was quite similar to that presented in the Christensen action. The Court said, page 433 (194 P. 2d 708):

"Appellant further contends that exoneration of defendant Brown necessarily relieves the corporation. The proof was that although a company

rule, required that the manager and an assistant be on the floor at all breaks, since one person was not sufficient in case of an emergency, but that on the night of the accident the last of the usherettes had left the theater before the accident leaving only Brown and the projectionist on duty. Thus the announced policy of appellant indicated an awareness of the need for adequate supervisory personnel. The jury therefore could have found that failure to have sufficient personnel efficiently to maintain the large theater in a safe condition was the proximate cause of the accident, and a verdict against the corporation and an acquittal of the manager is sufficient to sustain a judgment against the defendant corporation."

The same conclusion was reached in the following cases where the corporate employer was held liable and the manager or other employee was exonerated.

Jensen v. Southern Pacific Co., 129 Cal. App. 2d 67, 70, 276 P. 2d 703, 705-706.

McInerney v. United Railroads, 50 Cal. App. 538, 195 P. 958.

D. The Question of Active or Passive Negligence Was Not Raised in the Court Below.

Appellant contends as a final after-thought attempt to escape the effect of the verdict in the Christensen case that the negligence of the employer would be passive and that of the employee active. Even if we assume that such doctrine would apply to the circumstances involved in the Christensen case, it may not now be raised by appellant. Such issue was not raised

in the Court below and is now asserted for the first time on appeal.

However, it must be apparent that the negligence of Louis Stores, Inc., discussed above, was active and concurrent with that of its employee in causing the Christensen accident. The record in the Christensen action conclusively establishes the active nature of the employer's negligence. Acts done pursuant to express orders, failure to have sufficient personnel, or failure properly to instruct them is active negligence.

Newman v. Fox West Coast Theatres, 86 Cal. App. 2d 428, 432, 194 P. 2d 706, 708-709.

American President Lines, Ltd. v. Marine Terminals Corp., 234 F. 2d 753, bears no analogy to the present case. The right of indemnity was based on breach of the stevedores' contractual obligation. The shipowner and stevedore were not held jointly liable.

In this case Louis Stores, Inc., and Land were joint tort-feasors, and there was no contract between Land and the Store spelling out the basis for indemnity. Land was merely carrying out his employer's instructions.

CONCLUSION.

The findings of the Court below to the effect that (1) appellee Prudential did not insure Clifton Land and that (2) Louis Stores, Inc. was held liable for its independent negligence in the Christensen action are correct.

Appellant has not only failed to show that either of said findings is clearly erroneous, but has also failed to present to this Court a proper record to question said findings.

The judgment of the District Court should, therefore, be affirmed.

Dated, San Francisco, California,

April 3, 1957.

Respectfully submitted,

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No. 15,335

United States Court of Appeals
For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

VS.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and all
other underwriters at Lloyd's Lon-
don subscribing to Lloyd's Policy
No. EB32914-C,

Appellees.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

BRIEF OF APPELLEE

OHIO FARMERS INDEMNITY COMPANY.

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BRIEF OF APPELLEE

OHIO FARMERS INDEMNITY COMPANY.

Appellee, OHIO FARMERS INDEMNITY COMPANY (hereinafter referred to as "Ohio" to distinguish it from appellee, PRUDENTIAL ASSURANCE COMPANY LIMITED OF LONDON) faces a dilemma in responding to appellant's brief.

For reasons known only to appellant, the printed transcript of record designated by it does not contain the evidenciary basis upon which its argument is based that the Christiansen verdict and judgment was rendered under the doctrine of *respondeat superior*.

The printed transcript of record does not contain the testimony of Earl Correia to which appellant refers, or the testimony of Clifton Land, to which appellant also adverts. It is also silent as to the forms of verdict submitted to the jury in the trial of the Superior Court action in Alameda County and on which the Christiansen judgment was rendered and which demonstrates the issues which the court in that case found present. Similarly and directly connected with the omission of the forms of verdict is an omission of the instructions of the Alameda Superior Court to the jury upon the various issues apart from *respondeat superior* which the court gave to the jury as appropriate law for guidance in its deliberation for a verdict.

Under Section 608 of the *Code of Civil Procedure* of the State of California, it is the duty of the court in charging the jury to state all matters of law which it thinks necessary for their information in giving their verdict. The trial court observed the mandate of Section 608 of the *Code of Civil Procedure*, but appellant prefers to omit from the printed transcript of record all these cogent instructions and forms of verdict which were evidenciary exhibits before the district court and formed the basis for Judge Hamlin's decision.

It may be stated further that in the Alameda County Superior Court action the jury is presumed to have followed the instructions of the court.

Thus, appellant asserts error in the judgment heretofore rendered by the District Court without bringing before this court the evidence upon which Judge Hamlin's decision was based. It is not the appellant's choice to ignore the rules of this court, and appellee Ohio assumes that Rule 17 will be enforced, and that matters beyond the printed transcript at record will not be considered by this court.

Pursuant to Rule 17 of this court, the appeal should be dismissed and the arguments of appellant based on the testimony of Land and Correia discussed in appellant's brief, pages 20-25, should be disregarded.

Such reference to matters outside the record warrant dismissal.

On the other hand, if appellee Ohio respects the rules set forth by this court and yet this court should disregard its rules on appeal to permit reception of appellant's contentions based on matters outside the record, appellee would not be afforded an opportunity to answer the appellant's contents received by this court despite the basis of matters extraneous to the transcript of record.

Prudence does require in anticipation that this court cannot strike from the appellant's brief its attempt to re-try not only the factual issues decided in the District Court, but also those determined in the

Alameda Superior Court jury trial that appellee Ohio reply to appellant.

Before doing so, and, since appellant seeks to reverse the District Court decision, it should be recalled that the printed transcript omits any statement of the actual evidence before Judge Hamlin below, insofar as mention was made before him of the issues and evidence in support thereof which in turn were previously before the Alameda Superior Court.

Therefore this court is asked to review findings, conclusions and judgment, without having before it the evidence upon which the decision and judgment was based.

THE QUESTION PRESENTED.

The real question presented in this appeal is whether or not the findings of the District Court and the conclusions of law based thereon, which formed the basis of the judgment sought to be reversed was supported by the evidence before the District Court.

As this appellee has said, the designation of the record by the appellant reflects no ground for reversal set forth in it.

As to the specifications of error assigned and in the alternative in the event this court will consider argument of the appellant based on material not present in the record designated by it, as this appellee has pointed out, it is submitted that the District Court did not err.

REPLY TO SPECIFICATIONS OF ERROR.

1. As to the first specification of error that the court erred in finding a fact No. 4 (R. 50) on the basis of not having a Superior Court record that presented evidence to support a verdict against Louis Stores, Inc. upon the basis of "independent negligence."

In the first place the entire record of the Alameda Superior Court trial was not before the District Court.

The appellant was plaintiff below, and failed to fulfill its burden in proving its case by providing such record of the Alameda County proceedings, if any, which may have supported its allegations for declaratory relief. Now, without referring to the instructions on forms of verdict in evidence below in the District Court, appellant would seek reversal of the findings which are based on the actual evidence before the trial court, but not produced in the printed transcript of record.

The Christiansen judgment was rendered on a complaint which alleged (R. 35) in Paragraph VIII:

"At said time and place defendants, and each of them, so carelessly and negligently operated, maintained and controlled said market and said grocery department therein and said aisle open to the public therein so as to cause and permit a cardboard carton to be in said aisle in said grocery department in such manner so as to render said aisle dangerous to the passage of customers and business invitees in said market and said grocery department thereof lawfully using said aisle."

Paragraph IX (R. 35) alleges the proximate result of the negligence alleged in paragraph VIII:

“As a direct and proximate result of said carelessness and negligence of defendants, and each of them, as aforesaid, plaintiff was caused to trip and fall over said cardboard carton in said aisle and as a direct and proximate result of said fall in said aisle as aforesaid plaintiff received the injuries and damages hereinafter set forth.”

It is true that in paragraph V (R. 34) of the amended complaint, Correia and Land are alleged to be agents and employees of Louis Stores, Inc. but it is obvious that whatever dereliction is alleged to be the proximate cause of Mrs. Christensen's accident, it was the negligent operation, maintenance and control of the said market and said grocery department therein, which is alleged as that cause and the allegations of the complaint therefore are not framed on a theory of *respondeat superior*.

In the course of trial a nonsuit was rendered for the defendant Piperis, leaving to the jury the determination of liability of the defendants Louis Stores, Inc., Earl Correia and Clifton Land. The verdict found Land guilty of negligence as well as Louis Stores, Inc. and we submit that from uncontradicted testimony that Land's conduct, as the evidence reflects, was simply to follow the instructions of his employer and codefendant Louis Stores, Inc.

It is submitted that the appellant in this case had the burden of establishing by a preponderance of the evidence that the only basis of liability for Louis

Stores, Inc., was on a basis of *respondeat superior*, that Louis Stores, Inc. was guilty of no act of negligence whatsoever, and that the unauthorized act of its servant Land was the only negligence in the entire case. The appellant did not maintain this burden because the evidence is to the contrary.

Referring to the challenged finding, appellant makes no mention of the evidence considered by the District Court as a basis for its finding. For instance, the trial Court in its decision (R. 44) states:

“From the evidence presented, the court is unable to say that the finding of *respondeat superior* was the only finding that could have been made. The jury may have found Louis Stores Inc. negligent in not providing enough employees or in not properly instructing its employees what to do. THERE WAS ENOUGH EVIDENCE UPON WHICH TO BASE SUCH A FINDING and the jury were instructed that they could return a verdict against Louis Stores, Inc. and not against Land. The evidence at the trial could not remove the possibility that the jury made a finding that each defendant was independently negligent.”

In the findings (R. 48) the trial court found:

“Said amended complaint alleged that said Virginia Christensen suffered personal injuries on September 17, 1954 while shopping in a store operated by defendant Louis Stores, Inc. that DEFENDANTS AND EACH OF THEM SO CARELESSLY AND NEGLIGENTLY OPERATED, MAINTAINED AND CONTROLLED SAID MARKET AND SAID GROCERY DEPARTMENT * * *.”

And further (R. 49):

“The court instructed the jury in said action on the doctrine of respondeat superior and also instructed the jury that they could find a verdict against Louis Stores, Inc. and not against its employee, Clifton Land. THE COURT ALSO GAVE TO THE JURY IN SAID ACTION A FORM OF VERDICT WHICH FOUND IN FAVOR OF PLAINTIFF VIRGINIA CHRISTENSEN AND AGAINST DEFENDANT LOUIS STORES, INC., AND WHICH FURTHER FOUND IN FAVOR OF DEFENDANT CLIFTON LAND.”

As we have mentioned, the appellant has not presented to this Court in the printed transcript of record the evidence of the instructions or the forms of verdict which were before the District Court and upon which the foregoing findings were based.

Appellant, to the contrary, devotes half its argument, commencing at page 20 of appellant's brief, to a contention that there was only a question of *respondeat superior* before the Alameda Superior Court, which the District Court has found to be not so, and that such was the only question presented to the District Court itself.

THE DOCTRINE OF RESPONDEAT SUPERIOR.

Examining the argument of appellant, let it be stated that no one in this litigation from its inception has ever questioned the elementary concept of that doctrine.

No purpose is served, however, by the citation by appellant on page 20 of his brief (II A.) of *Canadian Indemnity Company v. U. S. F. & G.*, 213 F. (2d) 658, affirming *U. S. F. & G. v. Canadian Indemnity Company*, 107 F. Supp. 683. These cases have no relation to the controversy involved here. There was never any question in either of the cited cases that the doctrine of *respondeat superior* was the sole question involved. As Judge Murphy stated in *U. S. F. & G. v. Canadian Indemnity Company*, 107 F. Supp. 683, at page 685:

“The pleadings were drawn, the case tried and PROPOSED VERDICTS FRAMED upon the theory that Thomas Goff, while acting in the scope of his employment of Hedrick & Brown, negligently caused the injury.” (Emphasis ours.)

Respondeat superior is the doctrine of law wherein a principal becomes liable for the torts of an agent while acting within the scope of employment, even though contrary to instructions. The culpable act of the agent is unauthorized and public policy imputes liability to the principal.

Civil Code, 2838; *Restatement of Agency*, Sections 209, 243, et seq.

**THE DOCTRINE OF QUI FACIT PER ALIUM
FACIT PER SE.**

However, apart from the imputation of liability, a principal may also become liable for the act of a serv-

ant when the act is the result of express direction of the principal. This familiar doctrine of law is epitomized in the legal maxim, *qui facit per alium facit per se*. As the California District Court states in *Maberto v. Wolf*, 106 Cal. App. 202, at p. 206:

“ ‘The principle *qui facit (per alium facit per se)* must not be confounded with that of *respondeat superior*. It is a common misconception to attribute the liability of a master for the delicts of his servant in every case to the principle of *respondeat superior*. The servant may cause injury in doing the very thing that the master directs him to do. In that case the master is held liable because the law holds that the act is that of the master although done through the servant, under the principle *qui facit per alium facit per se*. He is therefore held responsible for his own act. But, on the other hand, the servant may cause an injury while engaged within the line or scope of his employment in doing an act which the master has not directed him to do or has specifically directed him not to do. It is the act of the servant, not the master, and the latter is held responsible on grounds of public policy; the liability in such case being expressed by the phrase *respondeat superior*. The principle is entirely distinct from that of *qui facit* and owes its origin to an entirely different source; the one to public policy and the other to the fixed principle of law and justice.’ ”

The uncontradicted testimony of Clifton Land demonstrates that his actions were in direct obedience to the direction of his master. His was not an unauthorized act but performed pursuant to the express

direction of Louis Stores, Inc., his principal. (See plaintiff's Exhibit No. 1.)

"Q. Can you tell us how that box got there?

A. Yes.

Q. How did it get there?

A. I called for it. My courtesy boy brought it out from the store room.

Q. Where were you when you called for it?

A. At the checking stand.

Q. How many customers were you taking care of at that time?

A. Several.

Q. Was this during the period after the Manager had gone home and left you there all by yourself to take care of customers?

A. Yes."

(p. 6, lines 5-14.)

"Q. You were busy waiting on customers?

A. Yes."

(p. 7, line 23.)

"Q. And then you went back up to your counter and continued to wait on this stream of customers?

A. That is correct."

(p. 9, lines 3-4.)

"Q. Mr. Land, you were not running this store, you just worked there, you didn't own it?

A. That's right.

Q. Your duties there were at the check stand after Mr. Correia left, am I correct?

A. Yes.

Q. And on this particular night you were checking customers out there when this customer asked about the Alhambra water, is that correct?

A. That's true.

Q. Your employer hires courtesy boys, Louis Stores hires them.

A. Yes.

Q. You are not the hiring or firing director of the employer?

A. I have nothing to do with it.

Q. You are just working there?

A. Yes.

Q. By the way, had Mr. Louis or any of the Louis Store people ever told you to stick at that check-out stand and attend to the customers?

A. That is our first duty.

Q. You were so instructed?

A. Yes.

Q. So far as this courtesy boy is concerned, did he not come from Louis Stores, too?

A. Yes.

Q. When you got this call for the water, you had customers at the check-out stand?

A. That is true.

Q. And you had the courtesy boy bring out the box of water?

A. That is correct.

Q. Through the direction of your directors or employer, he is not permitted to take stock out?

A. That's right.

Q. Your responsibility is that you go and take stock out?

A. When I have an opportunity.

Q. And your instruction from Louis Stores is that you stay at the check stand and check customers out and don't stock until you are free to do so?

A. That's true.

Q. And on this particular night, you followed those instructions, did you not?

A. That's true.

Q. Was this box just plain brown, or was it printed on, or what?

A. One side is white with blue letters.

Q. Everything you did that night to go and get the water was pursuant to orders of Louis Stores?

A. That's right."

(p. 11, line 6 to p. 12, line 16.)

See also the testimony of Earl Correia (plaintiff's Exhibit No. 2):

"Q. And your experience as the manager of that store had told you, had it not, that any low article in the public aisle where people shop, such as a single low box or a single can sitting out in the aisle below eye level would be a hazard to the safety of your customers?

A. That's right.

Q. You had been told that and told that, had you not, by your supervisor, Mr. Holmes?

A. That's right."

(p. 6, lines 14-20.)

"Q. Was Friday night a busier night usually than other nights?

A. Friday night is usually busier than the rest of the week."

(p. 8, lines 18 and 19.)

"Q. So that when you left about seven, there would be two hours of operation remaining with

just one clerk and one courtesy boy in charge, is that right?

A. That's right.

* * *

Q. What are the duties of a courtesy boy?

A. A courtesy boy is there to take out the groceries for customers, sweeping up, picking up boxes, etc., garbage, anything that has to be taken out, dumped out.

Q. Does a courtesy boy have anything to do with stocking merchandise on to the shelves?

A. No.

Q. As a matter of fact, is a courtesy boy permitted by you to put things up on the shelf?

A. He is not supposed to put anything up on the shelf.

Q. So that when you left the market at seven at night, the only person in the store that would be permitted by you to put anything out of a box on the shelf was this one man in charge of the store?

A. That's right.

* * *

Q. Was your usual custom to stock shelves with one man on duty?

A. Not normally. If he wasn't busy, he would stock.

Q. Had you not instructed this one man that if there were no customers there to wait on, that he could stock merchandise, but he was supposed to take a box and put the entire contents of the box on the shelf and then have the courtesy boy remove the empty box from the aisle?

A. Normally, yes.

Q. Your instructions to the one man in charge there was, if he had a box in the aisle, to stock the shelf he was working on until he had the box empty, and then get the box out of the aisle?

A. That's true."

(p. 9, lines 1-3, 16-26, p. 10, lines, 1-16.)

The Court should bear in mind counsel for the appellee who also appeared in the Alameda Superior Court action for Louis Stores, Inc., introduced no testimony concerning the instructions given to its employees by his client and it may well be inferred through the absence thereof that counsel well knew that Land at all times was fulfilling the direct instructions of his employer. Land's paramount instruction was to remain at the cash register and check-out station when customers were present and not to stock groceries until he had free time to do so.

The attention of the Court is directed to a clerical error in the plaintiff's request for admissions referring to an instruction appearing at lines 9 to 24 of page 3 of the Request for Admissions.

Actually, as given by the Court, the instruction read as follows:

"If you find from the evidence that any employee of defendant LOUIS STORES, INC., including either of the defendant employees, EARL CORREIA or CLIFTON LAND, was negligent while acting in the course and scope of his employment for said LOUIS STORES, INC., you are instructed that you must impute the negli-

gence of said defendant employee or employees to defendant LOUIS STORES, INC., and that if you find from the evidence that plaintiff is entitled to a verdict under the instructions given to you by the Court, such verdict should be rendered against defendant LOUIS STORES, INC., and such defendant employee or defendant employees if any found by you to be negligent.”

If the evidence in the Christensen trial demonstrated the negligence of Louis Stores, Inc. to be only that imputed under the doctrine of *respondeat superior*, there would have been no need for this instruction, leaving to the jury as a question of fact whether or not Correia or Land was negligent or was engaged in the course and scope of his employment with a subsequent imputation of liability to the principal if the jury found affirmatively on both questions. If *respondeat superior* was clearly established, the Court would have instructed Correia or Land were in the course and scope of their employment and that imputation of liability must follow if either or both were found to be negligent.

Of course, this instruction referred to by plaintiff was only one of the many given by the Court after duly considering all the evidence in the case.

The jury was also instructed:

“Defendant Land’s Proposed Instruction No.....

“You may find a verdict in this case against the defendant Louis Stores, Inc., and not necessarily against the defendant Land, who at all times com-

plained of was the servant of the master Louis Stores, Inc. If you find that the defendant Land was acting at all times under the direction, express or implied, of his master Louis Stores, Inc., then his actions were those of his master, even though performed by the servant."

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"Court's Instruction

"However, such fact would not excuse either defendant Land or Correia from liability to plaintiff for an act or omission of his, amounting to negligence on his part, from which plaintiff suffered injury as a proximate result, provided plaintiff was herself free from any contributory negligence.

"Approved by all parties.

Given, Ledwich, J."
(Defendant's Exhibit B)

The jury, therefore, could have exonerated Land or Correia on the evidence in this case concerning which the Court saw fit to instruct. If there was not evidence that there was independent negligence on the part of Louis Stores, Inc., the Court could have given no such instructions for any verdict against Louis Stores, Inc. without evidence sufficient to sustain it against that defendant alone would have been a self-stultifying verdict.

See

McCullough v. Langer, 23 Cal. App. (2d) 510;
Bradley v. Rosenthal, 154 Cal. 421.

Judge Ledwich in the Alameda County Superior Court action properly instructed the jury to this effect because of the fact that the evidence showed that Louis Stores, Inc., through its policies requiring one man to handle a large busy store with paramount attention to the cash register and check-out station, was negligent in the operation and management of its premises.

That this is uncontrovertible is further evidenced by the fact that Judge Ledwich presented five forms of verdict to the jury (Plaintiff's Exhibit 3), the fifth of which read as follows:

“We, the jury in the above entitled cause, find in favor of the Plaintiff Virginia Christensen, and against the Defendant Louis Stores, Inc., a corporation, and assess Plaintiff's damages in the sum of (blank) dollars.

“We further find in favor of Defendants Earl Correia and Clifton Land.”

Therefore, it must be conclusively presumed that the Superior Court properly instructed the jury (Louis Stores, Inc. has not appealed from the judgment) and that there was before the jury for its determination the question of the self-originating negligence of Louis Stores, Inc.

The mere fact that Land was held in a verdict with Louis Stores, Inc. is evidence that the jury found Louis Stores, Inc. negligent as well but it is not evidence that it so found on the basis of any imputable negligence. The verdict is entirely explainable under

the doctrine of *qui facit per alium facit per se*. Naturally, if Louis Stores, Inc. directed Land to perform his services negligently, it would not exonerate Land but it would not mean that Louis Stores, Inc. was solely responsible on a basis of imputed liability.

In appellant's argument, commencing at page 20 (II B) it is argued that *respondeat superior* was the only basis of a judgment heretofore found in the Superior Court action in Alameda County. Appellant argues on page 21 that it was Land who actually caused and permitted the box to be in the aisle way, but overlooks entirely the testimony (*supra*) concerning the directions of Louis Stores, Inc. that Land stay at the cash register when customers were present. It also, on the same page, mentioned that the jury was instructed on the doctrine of *respondeat superior*, but, again, omits any mention of the instruction based on the doctrine of *qui facit per alium facit per se* which was before the Superior Court as well as the District Court, and the forms of verdicts based thereupon.

The citation of *Pleasant Valley Association v. California Farm Insurance Company*, 142 Cal. App. (2d) 126, does not assist appellant. The action itself was one for declaratory relief and the controversy between the companies arose over an untried law suit entitled *Nungaray v. Pleasant Valley and Croker* (see 142 Cal. App. (2d), page 130.)

The determination that only a *respondeat superior* question was presented was based on the pleading which was much like the *Canadian Indemnity v. U. S. F. & G.* case (*supra*). It is readily distinguishable

from the Christensen case tried in Alameda County for the reason that the evidence upon which the verdict was based presented another basis of liability on the part of Louis Stores, Inc. than *respondeat superior*.

That Correia was exonerated by the jury is urged by appellant (Appellant's brief, pp. 23-24) as a reason why the Christensen judgment was based solely upon *respondeat superior*. It is difficult to follow the reasoning of appellant in this regard. In the first place, it disregards entirely the testimony of Clifton Land. Secondly, it disregards that Correia was absent from the premises at the time of this accident, having completed his day's work. It overlooks further the knowledge of Louis Stores, Inc. which allowed (plaintiff's Exhibit II, lines 9 and 10) only one clerk and one courtesy boy in the store with the courtesy boy not permitted to stock merchandise on one of their busy nights, with the clerk to stock shelves only if he was not busy at the cash register.

Regardless of the jury finding on Correia, which is explainable by his absence from the premises which had no box in the aisle at his time of departure, the fact was that Louis Stores, Inc. was negligent in not assigning sufficient personnel on its busiest night on this occasion in requiring its sole employee to remain at the check counter to wait on customers and only to remove merchandise from the aisles in the event that he was not busy. This presents a perfect example of the application of the doctrine of *qui facit per*

alium facit per se. In the final argument on this question contained in appellant's argument (II C) it is contended that the obvious negligence of Louis Stores, Inc. was "passive" and that Land alone was actively negligent.

If this Court will refer to the testimony of Clifton Land, *supra*, pp. 10-13, the conclusion is inescapable that on this night he was busy waiting on customers and his duties were at the check stand after Mr. Correia left. That he does not hire courtesy boys, that he ordered the courtesy boy to bring the box of water. That his instructions from Louis Stores, Inc. were to stay at the check stand and not stock until he was free to do so, and on this night he followed that instruction.

The Court very properly instructed in the Alameda County action:

"If you find that the defendant Land was acting at all times under the direction, express or implied, of his master Louis Stores, Inc., then his actions were those of his master, even though performed by the servant.

"QUI FACIT PER ALIUM FACIT PER SE.

"Court's Instruction

"However, such fact would not excuse either defendant Land or Correia from liability to plaintiff for an act or omission of his, amounting to negligence on his part, from which plaintiff suffered injury as a proximate result, provided plaintiff was herself free from any contributory negligence."

The situation is not at all in keeping with that mentioned in the case of *American President Lines, Ltd. v. Marine Terminals Corporation*, 234 Fed. (2d) 753.

The Court, in that decision, stated that it preferred not to rest its decision upon the ground that the negligence of American President Lines, Ltd. was passive, but it does point out that in this cited case, Marine Terminals Corporation, by contract, had undertaken to handle the beams involved as part of its duties. It also recites that there has been a complete disclosure to Marine Terminals that the beams were not equipped with locking devices. The decision was actually based solely upon the fact that regardless of the negligence of American President Lines, Marine Terminals had been completely instructed concerning the defects and that it was its failure to prudently handle the defective beams that was the active negligence present. It is noteworthy that in that decision the Court discusses a previous holding in *U. S. v. Rothchild International Stevedoring Company*, 183 Fed. (2d) 181, where an identical situation involving a defective winch, the details of which were completely related to the Stevedoring Company, resulted in a similar accident. In such a situation, one may well distinguish between passive and active negligence. Significantly, that position is not present for the appellant to make a similar contention in this case. The attention of the Court is directed to Section 441, *Restatement of Torts*, Subdivision b, which reads as follows:

“b. ‘Active’ and ‘passive’ negligence. The cases in which the effect of the operation of an intervening force may be important in determining whether the negligent actor is liable for another’s harm are usually, although not exclusively, cases in which the actor’s negligence has created a situation harmless unless something further occurs, but capable of being made dangerous by the operation of some new force and in which the intervening force makes a potentially dangerous situation injurious. In such cases the actor’s negligence is often called passive negligence, while the third person’s negligence, which sets the intervening force in active operation, is called active negligence.”

It is submitted that the negligence of Louis Stores, Inc., in not providing sufficient personnel, in requiring the clerk to pay paramount attention to the cash register and not to the safety of invitees in this store was not negligence creating a situation harmless unless something further occurs, but capable of being made dangerous by the operation of some new force in which the intervening force makes a potentially dangerous situation injurious.

The situation in so far as Mrs. Christensen’s injury was caused by independent negligence of Louis Stores, Inc. which was an issue presented to the jury of the trial Court under appropriate instructions and forms of verdict might well be described in the language of *Lacey v. P. G. & E.*, 220 Cal. 97, at page 98:

“The authorities in this State hold that where the original negligence continues and exists up to the time of the injury, the concurrent negligent act of a third person causing the injury will not be regarded as an independent act of negligence, but the two concurring acts of negligence will be held to be the proximate cause of the injury. * * *”

See also

Mecchi v. Lyon Van & Storage Co., 38 Cal. App. (2d) at 674.

What we have said here we believe disposes effectively of the contention of error specified on page 9 of appellant's brief and further specified as (1), (4) and (5).

APPELLEE DID NOT INSURE CLIFTON LAND.

Appellant attacks in his specifications of error the finding of the District Court No. VI (R. 51). The Court found therein that the Ohio Farmers policy did not insure Clifton Land and in its Conclusion of Law No. II so stated.

In seeking to reverse the finding of the District Court, appellant seeks to usurp the position of Louis Stores, Inc. in contending that the policy should be interpreted to include actual insurance coverage for Clifton Land under Endorsement No. 4.

It must be borne in mind that Louis Stores, Inc. has not been a party to any of this litigation. It has

raised no question whatsoever concerning its endorsement. Applicant is an entire stranger to the contract of insurance between Louis Stores, Inc. and appellee Ohio.

Appellant's counsel, while he did represent Louis Stores, Inc. in the Alameda County action (along with Thomas Piperis, another insured of Canadian Indemnity (see R. 37), never represented Louis Stores, Inc. in any personal representation.

Appellant seeks to find ambiguities in this endorsement, none of which complaint is voiced by the insured, Louis Stores, Inc., and none of which has ever been raised by Clifton Land who benefited by this supplemental agreement which provided a defense of the lawsuit against him.

APPELLANT IS A STRANGER TO THE INSTRUMENT.

The appellant had its own policy with Louis Stores, Inc. and was paid a premium for it with limits of \$100,000.00. It cannot contend that because of such contractual relationship with Louis Stores, Inc. that it is in a position to attack endorsement No. 4 or any other part of appellee Ohio's policy with which Louis Stores, Inc. is entirely satisfied. Louis Stores, Inc. finds no ambiguity in the policy and Louis Stores, Inc. alone would have the right to raise such an issue if it in fact existed.

We are concerned only with the relationship of the appellee Ohio's policy and the Canadian Indemnity

Insurance Company policy. Whatever provisions of Ohio Farmers Indemnity Company policy through endorsement No. 4 concerning defense of employees exist, such are not pertinent to this controversy which involves only the relationship of the two carriers for liability incurred by Louis Stores, Inc. So far as Canadian Indemnity is concerned, it insured Louis Stores, Inc. for a limit of \$100,000 with an "other insurance clause" which reads as follows:

"OTHER INSURANCE. If at the time of an accident there is any other insurance available to the insured (in this or any other carrier) there shall be no insurance afforded hereunder as respects such accident except that if the applicable limit of liability of this policy is in excess of the applicable limit provided by the other insurance available to the insured this policy shall afford excess insurance over and above such other insurance in an amount sufficient to afford the insured a combined limit of liability equal to the applicable limit of liability afforded by this policy."

The Ohio Farmers Indemnity policy similarly insured Louis Stores, Inc. with a limit of \$10,000 and it contains an "other insurance clause" which reads as follows:

"OTHER INSURANCE. If the insured has other insurance against a loss covered by this policy the Company shall not be liable under this policy for a greater proportion of such loss than the applicable limit of liability stated in the Declaration bears to the total applicable limit of liability of all valid and collectible insurance against such loss;"

These "escape clauses" are mutually repugnant and on well established case law must be read together and construed as pro rating proportionately the respective limits of liability. This has been established without question by such cases as *Employers Liability Corporation v. Pacific Employers Insurance Company*, 102 Cal. App. (2d) 188 and *Air Transport Manufacturing Company v. Employers Liability Assurance Corporation*, 91 Cal. App. (2d) 129.

See also:

Oregon Mutual Insurance Company v. United States Fidelity & Guaranty Company, 195 Fed. (2d) 958.

Appellant can not be heard to urge an ambiguity where none exists. Because appellant is a stranger to the policy, the rule expressed in *American Lumbermen's Mutual Casualty Company v. Trask*, 266 N.Y.S. 1 (affirmed 191 Northeastern 557) should be applied. There the Court stated at pages 4 and 5:

"If we were construing the policy from the standpoint of Miss Pilbeam, the assured, one of the parties to the contract, then as against the insurer, the policy would be strictly construed as to its meaning and intent". (Citations.)

The rule of strict construction against the insurance company is not, however, applicable in favor of the defendant. The plaintiff is here seeking to enforce it as against a stranger to the contract. See also *Nieschlag & Company v. Atlantic Mutual Insurance Company*, 43 Fed. Supp. 797, 799, affirmed 126 Fed. (2d) 834 (2 C.C.A.).

But, the conclusive fact is that appellant has pointed out no doubt or ambiguity in the language of the endorsement. There is, then, no ambiguity or uncertainty in the language to be *interpreted* in favor of anyone. There is no inconsistency between the endorsement and the body of Ohio's policy (Item 1). Clifton Land clearly is not an assured under either the "Definition of Insured" nor the endorsement.

Hence, as stated in *Continental Casualty Co. v. Phoenix Construction Co.*, 46 A.C. 429, 437, with reference to a similar contention:

"An insurance company has the right to limit the coverage of a policy issued by it and when it has done so, the plain language of the limitation must be respected."

Appellant also contends that all five paragraphs of the endorsement must be given effect. Such contention presents no problem here. The construction given to the endorsement by the Court below does give effect to the whole endorsement. There is no conflict between the five paragraphs. The Court found that none of the paragraphs state or imply that Land is an assured under the policy. Paragraphs 1 and 2 are by their express language for the benefit only of the assured, Louis Stores, Inc. Paragraphs 4 and 5 refer again to the coverage of Louis Stores, Inc., as is obvious from paragraphs 1, 2 and 3 of the endorsement. Furthermore, paragraphs 4 and 5 are not involved on the facts of this case. In order to avoid any possible question on the matter, paragraph 3 expressly and

clearly provides that there is no privity of contract between Ohio and any employee of Louis Stores, Inc.

Appellant does not, of course, contend that paragraphs 1, 2, 4 and 5 expressly provide that an employee of Louis Stores, Inc. is an assured. Appellant contends that the endorsement as a whole should be so *construed*. On the other hand paragraph 3 expressly and clearly provides that an employee is not privy to the policy and shall not, by virtue of the endorsement, have any rights which he would not otherwise have had. Appellant refers to paragraph 3 as a recital. It is, however, an express, contractual provision of the policy. Appellant's contention, then, is this: Paragraphs 1, 2, 4 and 5 are not free from doubt and should be construed against Ohio in favor of appellant. Paragraph 3 is clear but is a recital. We think that, under these circumstances, appellant's present contention is completely refuted by its own quotation from II *Williston on Contracts*, page 1201, note 98, as follows:

“If the recitals are clear and the operative part is ambiguous, the recitals govern the construction. * * *” (Appellant's Brief, page 16.)

Endorsement No. 4 of the Ohio Farmers policy entitled “Defense of Employees” merely provides for certain supplemental coverage extended to its named insured Louis Stores, Inc.

Endorsement No. 4 consists of five paragraphs.

Paragraph 1 states that the Company will defend in the name of and on behalf of any employee upon cer-

tain notice to be made by the named insured and in certain defined instances. These instances are limited to those in which the named insured is joined or could be joined and further actions in which the Company is obligated to defend the named insured whether joined or where it could be joined.

Paragraph 2 states that the Company will make payment within the limits of the declarations in the policy of loss by liability imposed by law on any said employee but conditions payment on the same terms as recited in paragraph 1.

Paragraph 3, however, states very definitely that the policy of insurance is a contract between the Company and its named insured, that there is no privity of contract between the employee and the company and no rights are conferred upon the employee.

Paragraph 4 limits the defense even further in that it requires the act of the employee to be within the scope of his employment. In other words, this endorsement limits its application solely to instances in which he is acting in good faith in behalf of his employer.

Therefore, it must be apparent that Endorsement No. 4 not only by its title but by its content simply extends supplemental obligations to the named insured, the contracting party.

The existence of Endorsement No. 4 leaves the employee without any remedy to enforce the provisions of the endorsement. It is simply a contract for the benefit of the employer. Under the policy issued to

the named insured the Ohio Farmers Indemnity Company has full right of subrogation to the insured's rights. Thus, it could subrogate against an employee who may have caused payment to be made on behalf of the named insured in a suit against Louis Stores, Inc. alone. Because of the limitations in Endorsement No. 4 the Company could still proceed against such an employee and the employee could not assert that as an insured the Company could not take such action. Obviously if the employee was an insured under this policy there could be no right of subrogation against him. This endorsement does not make an employee an insured.

Thus, appellant confuses what is merely a supplementary and extended protection for the benefit of the named insured for extended coverage to make an insured of an employee.

The only effect of Endorsement No. 4 in the Christensen case was to require the Ohio Farmers Indemnity Company to provide a defense for Land (as well as Correia) on behalf of Louis Stores, Inc., which of course was insured not only by Ohio Farmers Indemnity Company but by the plaintiff Canadian Indemnity Insurance Company.

It would be impossible for Land to sue on the Ohio Farmers Indemnity Company policy against the Company because of the absence of privity of contract between the Company and Land. Nor could any judgment creditor of Land sue Ohio Farmers Indemnity Company pursuant to the provisions of Section

11580 of the Insurance Code of the State of California which contains mandatory provisions required of policies issued in this State, and which, among other provisions, relates:

“(2) A provision that whenever judgment is secured against the *insured* . . . in an action based upon bodily injury, . . . then an action may be brought against the insurer on the policy and subject to its terms and limitations, by such judgment creditor to recover on the judgment.” (Emphasis ours.)

To sum up, it is therefore quite apparent that Land was not an additional insured under the policy issued by Ohio Farmers Indemnity Company but merely a person for whom supplemental benefits were extended to the named insured, Louis Stores, Inc.

The Court below found that Land was not an assured under Ohio's policy based on the language of the endorsement and the applicable rules of construction. The finding and conclusion of the Court result in an equitable distribution of the loss between the two primary insurers. Appellant has shown no proper basis at all for disturbing the considered opinion of the Court below.

Appellant's attempted construction of the endorsement would not only give it a meaning not found in the language thereof but would also completely ignore the clear, express provisions of paragraph 3. The authorities cited by appellant itself refute the propriety of such construction.

CONCLUSION.

The position of the appellant is that it would rewrite the Endorsement 4 and interpose its own thinking and its own words and substituted phrases in an effort to change the plain terms of a supplementary defense agreement for the sole purpose of avoiding its own contract of insurance for Louis Stores, Inc. It has not established that appellee Ohio was an insurance carrier for Clifton Land OR, WHAT IS MORE IMPORTANT, THAT THE DISTRICT COURT CLEARLY ERRED IN ITS FINDING THAT LAND WAS NOT INSURED BY APPELLEE OHIO.

It is further contended that, as the carrier for Louis Stores, Inc., it has a right of subrogation against Clifton Land because it concludes the Alameda County verdict in the Christensen case was based solely upon the basis of *respondeat superior*.

There is no need to again recite the simple elements of the doctrine of *respondeat superior*, but this Court must have in mind the doctrine of *qui facit per alium facit per se*, which was before the Trial Court and the District Court and which appellant ignores by omission from the printed transcript of record.

As we have heretofore remarked, this appeal should be dismissed because of the false perspective presented to this Court by such omissions from the transcript. This Court cannot be expected to reverse a judgment when the appellant has not abided by its rules on ap-

peal to present the pertinent evidence before the Trial Court below.

The printed Transcript of Record does not reflect the District Court erred.

It is submitted that the judgment should be affirmed.

Dated, San Francisco, California,

April 8, 1957.

LEO J. WALCOM,

*Attorney for Appellee Ohio
Farmers Indemnity Com-
pany.*

No. 15,335

United States Court of Appeals
For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and
all other underwriters at Lloyd's
London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

APPELLANT'S REPLY BRIEF.

EDWARD A. FRIEND,

519 California Street, San Francisco 4, California,

Attorney for Appellant.

FILED

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PAUL P. O'BRIEN, CLERK

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THE CANADIAN INDEMNITY COMPANY,
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OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
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London subscribing to Lloyd's Pol-
icy No. EB32914-C,

Appellees.

Appeal from the United States District Court for the
Northern District of California,
Southern Division.

APPELLANT'S REPLY BRIEF.

I.

REPLY TO APPELLEES' ARGUMENT THAT TRANSCRIPT OF RECORD IS INCOMPLETE.

(A) The testimony of Land and the testimony of Correia were both placed in evidence before the United States District Court as exhibits.

Both briefs for the two appellees in this case assert repeatedly and emphatically that this Court is foreclosed from considering the testimony of Land and

Correia and arguments based thereon for the reason that such testimony was not reprinted in the transcript of record designated by appellant under Rule 17 of this Court. (Brief of Ohio Farmers, page 2, *et seq.* and brief of Prudential Assurance, page 34.) It appears, however, that such testimony was placed before the District Court as Exhibits 1 and 2 in evidence. Exhibit 3 contains the forms of verdict offered the jury in the State Court action, and Exhibits A and B refer to instructions given the jury by the State Court.

The writer of this brief, embarking on his first case, before a United States Court of Appeals, read Rule 17 very carefully and twice made specific oral inquiry at the office of the Clerk of this Court concerning just what material had to be designated for printing. On each such occasion, the undersigned was specifically informed by the Clerk's office that this Court, in the interest of economy and brevity, made it a practice to consider, and would consider, exhibits received in evidence by the United States District Court and made part of the record on appeal in this Court, even though such exhibits were not reprinted in the transcript of record. It was in direct reliance upon such specific information that the undersigned did not have the exhibits reprinted as part of the transcript of record. If the information given to the undersigned was erroneous, the undersigned will move the Court at the hearing of this case for its order permitting all parts of the exhibits to be printed in full, and deferring submission until such printing may be accomplished.

(B) The record on appeal is complete in this case.

The certificate of the Clerk of the United States District Court to the record on appeal is reprinted at R. 62-64. As may be seen at R. 64, Plaintiff's Exhibits 1, 2 and 3 and Defendants' Exhibits A and B, all of the evidence before the District Court, were duly designated as part of the record on appeal. This fact distinguishes clearly the two cases cited at the top of page 34 of Prudential's brief. In both of those cases, certain exhibits were not designated by appellant as part of the record and therefore were not before the Appellate Court. In the case at bar, all exhibits were designated as part of the record and are before the Appellate Court.

II.

APPELLEES MISCONCEIVE WHERE THE BURDEN OF PROOF LIES IN A DECLARATORY RELIEF ACTION.

This is an action in declaratory relief. Appellant seeks a determination of the rights and liabilities of all carriers with reference to the liability assessed in the State Court action against Louis Stores, Inc., and its employees, paragraph V of first amended complaint in declaratory relief, R. 4. In this kind of action, both sides ask the Court to apply all the law that may be applicable and each side introduces all the evidence which it feels may sustain its contentions. Both appellees claim emphatically in their briefs that appellant had the burden of proof, Ohio Farmers' brief, bottom of page 6, and Prudential's

brief, bottom of page 26. In this part of the reply brief, appellant will seek to show that appellees err in their contentions about where the burden of proof lies in this kind of action; that each side to a declaratory relief action has the burden of proving its affirmative contentions; that appellant has proved, beyond any doubt, its contention that the State Court verdict against Louis Stores, Inc. was based on *respondeat superior*; that appellees make the affirmative contention that the State Court verdict was, or may also have been, based upon alleged "independent negligence" of Louis Stores, Inc.; that appellees have not sustained their burden of so showing; that, as a matter of fact, appellees have not placed before the District Court or this Court one shred of evidence to support their affirmative contention, although they had ample opportunity to bring before the District Court all of the proceedings of the State Court; and that appellees somehow seek to twist appellant's alleged failure to disprove completely their affirmative contention into an argument that such contention has been proved, when, in fact, no evidence at all has been adduced in support of it.

(A) In an action for declaratory relief, the burden of proof depends upon the issue or contention being asserted.

In *Pacific Portland Cement Co. v. Food Machinery & Chemical Corp.*, 178 F. 2d 541, this Court said, at 178 F. 2d 546:

"In the last analysis, whether we are dealing with an ordinary action or one for declaratory relief, the question of who has the burden of

proof is determined not so much by the position of the parties or by choosing *who the actor in the law suit is*, as by the *nature of the relief asked for and granted*. (Emphasis by the Court.) Borchard, *Declaratory Judgments*, 2d Ed., 1941, pp. 404-409. So far as the Federal declaratory judgment statute is concerned, the matter has been very lucidly stated by the Court of Appeals for the Eighth Circuit in *Reliance Life Insurance Co. v. Burgess*, 8 Cir., 1940, 112 F. 2d 234, 237: 'The question as to who must sustain the burden of proof in a declaratory judgment suit is a comparative new one, which we think does not permit of a categorical answer. It must depend, as in other classes of litigation, upon the condition of the pleadings and the character of the issues at the time the question is presented. . . .'

Similarly, in *Northwestern National Casualty Co. v. Bettinger*, 213 F. 2d 200, affirming 111 Fed. Supp. 511, the Court held that after the plaintiff insurer had made out a *prima facie* case, the burden of proof then shifted to the intervenor, 111 Fed. Supp. at 515-516.

This question is discussed by a recent note in 9 Okla. Law Review 180.

(B) Plaintiff-appellant has proved that the State Court's verdict against Louis Stores, Inc., was necessarily based upon respondeat superior.

The material in appellant's opening brief, from the bottom of page 4 to the middle of page 7, and the discussion under subhead B, pages 20-25, of said brief, are hereby incorporated by reference without repeating at length.

It is clear from the facts admitted by stipulation in the United States District Court that the State Court pleadings alleged all acts of Clifton Land were committed in the scope and course of his employment for Louis Stores, Inc., and it is also clear that the State Court pleadings admitted such allegation. It is clear from Land's testimony, all of which is in the exhibits before this Court, that it was he who deliberately pushed the carton into the position where Mrs. Christensen tripped over it. It is clear that the State Court jury, in returning its verdict against Land, necessarily found him negligent. It is clear from the State Court Judge's instruction to the jury, reprinted at R. 25 as part of appellant's request for admissions in the Court below, that the jury was instructed that if they found either Land or Correia negligent, while acting in the course and scope of their employment for Louis Stores, Inc., then the jury *must* impute such negligence to the employer Louis Stores, Inc., and find against both. That instruction is also printed in brief for Ohio Farmers at pages 15-16.

Since the only allegation against Land was negligence, since it was admitted that Land was acting in the scope of his employment at the time, and since the jury actually found against Land, and since they were instructed that if they found against Land they must also find against Louis Stores, Inc., it has been proved that that verdict was based upon *respondeat superior*.

(C) Appellees contend that the verdict against Louis Stores, Inc., was also based upon "independent negligence"; but they have adduced absolutely no evidence to support their contention.

Appellees' argument for this proposition is based almost wholly upon an instruction given the State Court jury by Judge Ledwich. That instruction was submitted by Mr. Walcom, who represented Land and Correia in the State Court action at the instance of appellee Ohio Farmers, and it is before this Court as Exhibit B in evidence. It is also reprinted in Ohio Farmers' brief, at pages 16-17. The only other item by which appellees seek to support their argument is the fact that the State Court Judge prepared several forms of verdict for the convenience of the jury, including one verdict against the corporation only (part of Exhibit 3). That form of verdict, however, was *specifically rejected* by the jury which, as has been reiterated, found against Land based on his negligence.

The most significant observation to be made concerning that instruction and that form of verdict is that neither of them represents any *evidence* that was before the State Court in the personal injuries action. They represent only Mr. Walcom's *theory* of such evidence—a theory which was specifically rejected by the trier of fact in the State Court action and which is therefore of no value in determining the issues before this Court.

Under the law which governs the State Courts in California, neither a jury instruction nor an unused form of verdict is evidence. Evidence is defined by

California Code of Civil Procedure 1823 as the means, sanctioned by law, of ascertaining in a judicial proceeding the truth respecting the question of fact. C.C.P. 1827 specifies the four kinds of evidence, as follows:

- “1. The knowledge of the court;
2. The testimony of witnesses;
3. Writings;
4. Other material objects presented to the senses.”

By “the knowledge of the court” the California Legislature did not mean the reasons that lead the Court to give jury instructions offered by any party in an effort to prove its theory of the case. The legislature meant objects of judicial notice, as specified in C.C.P. 1875 under the heading “Knowledge of the Court.”

The only *evidence* from the State Court proceedings that was placed before the United States District Court and before this Court is Exhibits 1 and 2, the complete testimony of Land and Correia. It is admitted that Mr. Walcom called no other witness in the State Court action; request for admissions, paragraph 8, at R. 24-25.

Attention is directed to the precise language of the State Court’s instruction which is Exhibit B before this Court. The State Court said, albeit parenthetically, that Land *was* at all times complained of the servant of the master Louis Stores, Inc. The State Court Judge impliedly told the jury, in the first half of that instruction, that *if* they found Land was

merely following instructions of his master, then they need not find against Land; hence the jury must have found, contrary to what appellees contend, that Land was *not* merely following directions, and that Land was negligent.

In this connection, the cases cited at pages 35-36 of Prudential's brief are not in point. In *Benson v. Southern Pacific Co.*, 177 Cal. 777, 171 P. 948, the jury failed to find one way or the other concerning the employee and the Court held that the error was waived by a failure to request that the jury be directed to find on that issue.

The case of *Newman v. Fox West Coast Theatres*, 86 Cal. App. 2d 428, 194 P. 2d 706, is distinguishable on the grounds that the employee was exonerated; that the employee did not actually *create* the danger, but merely omitted to clean it in time; and that the rules promulgated by the defendant corporation required more people to be there than were there on the night in question. In the case at bar, Land actively created the danger; Land was held liable; and Correia, the store manager who *determined* the number of people to be present at any one given time, was exonerated.

In *Jensen v. Southern Pacific Co.*, 129 Cal. App. 2d 67, 276 P. 2d 703, the employee was exonerated. In that case, however, there was *evidence* that the railroad was negligent in its determination of what warning signals should be erected. In the case at bar, there was no evidence of any kind of negligence or even of acts by the corporation other than through

Land, who was held negligent, and through Correia, who was not held negligent.

The case of *McInerney v. United Railroads*, 50 Cal. App. 538, 195 P. 958, cited by appellee Prudential, at page 36 of its brief, is, on analysis, favorable to appellant's position herein. In that case, the employee, who was following specific orders, was exonerated. He had been ordered to send out guards, who assaulted the plaintiff. In the case at bar, however, there is no evidence that Land had been ordered to leave the box in the aisle; if he had been so ordered, then he should have been exonerated. The evidence is just the opposite: Land had been ordered never to leave a box in the aisle. Land was not merely following orders and that is why he was held liable, in spite of Mr. Walcom's able efforts to persuade the jury otherwise. If the State Court trial included any *evidence* of negligence on the part of Louis Stores, Inc., other than the acts of Land and the acts of Correia, appellees herein had ample opportunity over a long period of time to bring such evidence to the attention of the United States District Court. They have failed completely to do so, thereby failing in their burden of proving their contention that such evidence existed.

Lastly, appellee Ohio Farmers argues at page 18 of its brief that it "must be conclusively presumed" that the Superior Court properly instructed the jury because Louis Stores, Inc., has not appealed from the judgment. Such is not the case. Judge Ledwich merely leaned over backward, so to speak, giving Mr. Walcom's instruction, in order to give Mr. Walcom every

opportunity to convince the jury of his theory of the case, namely, that Land should be exonerated because he was merely following instructions. If there was error in giving Mr. Walcom's instruction (Exhibit B), that error is harmless, in view of the result, and an appeal would be an idle gesture. It is certain that had the Superior Court jury found against Louis Stores, Inc., only, exonerating both the man who left the box in the aisle and the man in charge who instructed him and determined the number of people on duty, then there would have been an appeal by Louis Stores, Inc., and it would have been successful.

III.

APPELLEES ARE SPECIFICALLY OBLIGATED BY THEIR POLICIES TO PAY THE STATE COURT JUDGMENT AGAINST CLIFTON LAND.

It would be redundant to repeat here the argument made at pages 10-19 of appellant's opening brief concerning Endorsement No. 4 of the Ohio Farmers' policy and the specific request made under it by the attorney for Louis Stores, Inc., that Ohio Farmers assume the defense of the employees. It should be pointed out, however, in reply to the arguments made in the appellees' briefs, in particular, Prudential's brief, pages 9-18, that the term "insured" embodies a legal conclusion which a Court may apply to a relationship. The essential fact is not, as appellees seem to think, whether the insurance company chooses to apply the word "insured" to an individual. The

question is whether or not an insurance company, under certain circumstances, undertakes to indemnify another person under its policy. If it does, as clearly Ohio Farmers has in this case, then it is the insurer, and the person so indemnified is the insured, California Insurance Code, Section 23. It is specious and meaningless to argue, as appellees have, that in one breath they may say Land is not an "insured," and in the next breath that their Endorsement No. 4, even though it specifically obligates them to pay any loss by liability imposed upon any said employees, is a mere "supplemental agreement," without any significance and without imposing any obligation upon appellees. Appellees make this argument in the face of paragraph 5 of Endorsement No. 4, R. 53, reading,

"5. *The Insurance provided by this endorsement shall be excess insurance over any other valid and collectible insurance available to any employee of the named insured.*" (Emphasis supplied.)

(A) Appellees' argument of "stranger to the contract" has no relevance to this case.

In this argument, appellees once more ignore the nature of the declaratory relief suit. Appellant requests this Court to consider all the law applicable in making a just declaration of the rights and liabilities of all parties to this suit, based upon all the circumstances. Of course, one insurance company is always a "stranger to the contract" of another insurance company. Yet, it is clear that declaratory relief actions lie among insurance companies, and in such

actions the courts interpret the contracts in the light of all the applicable statutes and precedents. In *Canadian Indemnity v. U. S. F. & G.*, 213 F. 2d 658, it seems clear that U. S. F. & G. was a "stranger to the contract" between Canadian Indemnity Company and Thomas Rigging. That fact is absolutely without significance. Even Thomas Goff, held to be Canadian's insured, was a "stranger to the contract," similarly without significance.

Similarly, in *Continental Casualty Co. v. Phoenix Construction Co., et al.*, 46 Cal. 2d 423, 296 P. 2d 801, each company was no doubt a "stranger to the contract" of the other. This argument sheds no light upon the declaration sought.

Referring more specifically to Prudential's argument, the case of *Transportation Guarantee Co. v. Jellins*, 29 Cal. 2d 242, 174 P. 2d 265, is not at all in point because it does not construe a contract of insurance at all.

American Lumbermen's Mutual Casualty Co. v. Trask, 266 N.Y.S. 1, cited at page 13 of Prudential's brief and at page 27 of Ohio Farmers' brief, involves a specific statute, namely, the financial responsibility law of New State interpreted by a New York Court. It was not a declaratory relief action. It does not state the law of California. It dealt only with the subrogation rights of the carrier against a third party who had borrowed the car of its insured, as those rights existed under a specific state statute. Hence, it is not here in point.

Chamberlin v. City of Los Angeles, 92 Cal. App. 2d 330, 206 P. 2d 662, cited at page 14 of Prudential's brief, is not in point at all. It holds only that no cause of action lies against an insurance company unless a final judgment is first obtained against a person whose liability the insurance company is obligated to discharge.

In the middle of page 13 of Prudential's brief, Prudential remarks that . . . "the rule (that any ambiguity must be resolved against the insurer) has no application if the insured is responsible for the language used. . . ." This statement on the part of Prudential is grossly misleading, if it seeks to imply to this Court that Louis Stores, Inc., was in any way responsible for the language used in that endorsement. There is no such evidence, nor even such suggestion and it is submitted that the presumption is otherwise.

Lastly, at page 18 of its brief, Prudential miscites the case of *Vyn v. Northwest Casualty Co.*, 47 A. C. 84, 301 P. 2d 869, for the proposition that appellees need not pay Land's liability to Mrs. Christensen in this case, because the event (the accident) was known prior to the time that Land's defense was assumed by Ohio Farmers. The *Vyn* case holds that no contract of insurance had yet come into being at the time of the accident, because the premium was not yet paid. Hence, there was no contract of insurance at all. In the case at bar, there is no dispute that there were valid contracts of insurance on the part of both appellees. The only question is whether those con-

tracts obligate appellees to discharge Land's liability under the facts.

(B) Reply to Prudential's argument that it does not insure Land, even if Ohio Farmers does.

Two groups of underwriters at Lloyd's London had excess policies in force at the time of the Christensen accident, both of them specifically based upon the Ohio Farmers' policy as the underlying policy. Ohio Farmers carried \$10,000 worth of coverage. The first Lloyd's excess policy, that of appellee Prudential and its group of underwriters, carried \$40,000 beyond the Ohio Farmers \$10,000, thus raising the coverage to \$50,000. The second Lloyd's policy, that of Frank B. Allison and other underwriters, carried \$450,000 beyond the previous \$50,000, thus making the total \$500,000. (Findings of fact VIII and IX, R. 54.) (The second group of Lloyd's underwriters, although defendants in the United States District Court suit in declaratory relief, were not made parties to the appeal, because the judgment against Clifton Land was for less than \$50,000, so that their policy would not come into effect.)

At pages 18-25 of Prudential's brief, it argues that it is not obligated to discharge the State Court judgment against Land, regardless of the liability of Ohio Farmers. This assertion is made, in spite of the fact that its policy specifically states that the Ohio Farmers policy is the underlying policy to which it is excess.

At page 19 of its brief, Prudential cites California Insurance Code 387 for the proposition that a policy

of insurance may be applied only to the interest of "the person intended to be insured . . ." With that abstract statement of principle, appellant has no quarrel, but Prudential misapplies it to the instant case. Endorsement 4 to Ohio Farmers' policy, an integral part of the policy underlying Prudential's policy, says that Ohio Farmers will discharge the liability imposed upon Land. Hence, Land is specified in the policy. For the most recent statement of state law on this subject, attention is directed to *Olson v. Standard Marine Insurance Co. Ltd.*, 109 Cal. App. 2d 130, 240 P. 2d 379 (hearing denied by State Supreme Court). In that case, the argument made by defendant insurer was similar to the argument advanced by Prudential herein. The California Appellate Court, at 109 Cal. App. 2d 135, after stating that argument, held as follows:

"... It reasons therefrom that only respondent Olson was insured and only as to such property in which she had an insurable interest. With this construction of the policy we cannot agree. It not only violates the clear import of the language but also is contrary to the well established rules of construction of insurance policies. Appellant would have us hold that only the property owned by a member of respondent Olson's family that is insured is that in which respondent Olson has an insurable interest such as a community property interest in the property of a spouse or an interest in that of a minor child. Such a construction would give little if any effect to the 'family' clause since members of a family own much of

such property outright. Furs and jewels of a wife are frequently the result of gifts and therefore not community property. It would result in appellants being absolved from liability on 80% of the articles for which it accepted a premium. If we considered these terms of the policy were ambiguous we would be forced to come to the same conclusion because of the established rules of construction. A contract of insurance should be most strongly construed against the insurer if such construction is fairly reasonable . . .”

At pages 20 and 21 of its brief, Prudential admits, as it must, that its policy by its own language is subject to the same warranties, terms and conditions as are contained in, *or as may be added to* the policy of the primary insurers. Prudential then proceeds to state on page 22 that the expression “warranties, terms and conditions” excludes paying the liability imposed on Land as required by Ohio Farmers’ policy Endorsement No. 4. It argues, without citation of any authority, that the word “terms” should be equated with “hazards insured against,” and includes no more. It is submitted, as a matter of basic semantics, that if the underwriters at Lloyd’s in drafting their policy had meant “hazards” instead of “terms,” they could easily have said “hazards.” “Terms” includes more than “hazards” as a matter of ordinary dictionary definition, apart from any question of law. Thus, the following definitions are submitted from Webster’s New World Dictionary of the American Language (1951):

Hazards: "risk; peril; danger; jeopardy;
 Terms: conditions of a contract, agreement, sale,
 etc. that limit or define its scope or the action
 involved . . ."

Prudential next makes the following argument at pages 23-24 of its brief: That since Prudential and the other Lloyd's underwriters are not obligated to investigate and defend, and because Ohio Farmers' responsibility to discharge the judgment against Land is conditioned upon its having defended Land, that therefore Prudential has no responsibility to discharge the judgment against Land.

It is submitted that this argument by Prudential may quickly be reduced to an absurdity. Under their excess policy, the Lloyd's underwriters have no obligation to investigate or defend *anyone*, including the named insured Louis Stores, Inc., condition No. 5 of Prudential's policy, R. 16. Referring now exclusively to Louis Stores, Inc., the named insured, it was Ohio Farmers that had the specific obligation to defend any suit against the insured alleging injury covered by the policy, and to pay all judgment taxed against the insured in any *such suit*, R. 2. Ohio Farmers was similarly obligated to defend the employees under Endorsement No. 4, and then to pay the liability assessed against them. Surely, Prudential could not argue that it was not obligated to pay a judgment against Louis Stores, Inc., simply because Ohio Farmers' liability to pay that judgment was conditioned upon Ohio Farmers' obligation to defend, while Prudential had no obligation to defend. The case with

reference to the employees is just the same. In other words, the Lloyd's policies are excess policies for the payment of liability after liability has been established. The Lloyd's policies specifically say that they need not defend, but that defense is the responsibility of the primary carrier, Ohio Farmers. If this argument of the Lloyd's underwriters applies to Land, then it applies similarly to the very named insured, Louis Stores, Inc. It would mean that Lloyd's has no liability under any circumstances to anyone. But such a conclusion would be absurd.

To make perfectly clear Prudential's obligation to discharge the liability imposed upon Land, however, attention is again directed to Endorsement No. 3 of Prudential's policy, printed in full at R. 20-21. It reads in part as follows:

"In consideration of the premium charged, it is understood and agreed that wherever the assured has contracted to protect any *individual*, firm, or corporation by insurance such *individual*, firm, or corporation shall be deemed an assured under this policy but the liability of the underwriters as respects such *individual*, firm, or corporation shall be limited to the amount of insurance contracted to be carried by the assured but in no event shall such liability in the aggregate exceed the underwriters' limit of liability as expressed in this policy. It is understood, however, that this policy does not insure any individual, firm, or corporation *whose operations or business is not incidental or necessary to the business of the assured herein named.*" (Emphasis supplied.)

It is submitted that clearly Land is covered by Prudential's Endorsement No. 3, for certainly Land's business was incidental and even necessary to the business of the named insured.

At page 24 of its brief, Prudential discusses and misquotes its Endorsement No. 3. Prudential's brief at page 24 reads in part as follows:

“Endorsement 3 on the Prudential policy provides that persons *with* whom the insured (Louis Stores, Inc.) has *contracted* to protect by insurance shall be deemed insureds under Prudential's policy with specified limitations. . . .” (Emphasis supplied to the word “with”.)

It is submitted that Prudential, in its discussion at page 24 of its brief, deliberately reads the word “with” into its Endorsement 3, where no such word appears. Prudential thus seeks to imply that Endorsement 3 is restricted to a situation where Louis Stores, Inc., has contracted *with* another person, firm or corporation that Louis Stores, Inc., will protect such other party by insurance. The endorsement, however, is not so restricted. The endorsement speaks for itself. It means that where Louis Stores, Inc., has contracted *with* Ohio Farmers, the underlying insurance company, to protect an individual, firm or corporation by insurance, that then such other party becomes an insured under the Prudential policy. The very type of agreement contemplated by Prudential's Endorsement 3 is the agreement represented by Ohio Farmers' Endorsement 4.

Surely, it is illogical to hypothesize that Prudential's Endorsement No. 3 contemplated some private contract between Louis Stores, Inc., and an unknown party, which contract might be completely unrelated to the Ohio Farmers' insurance policy, and which contract might not even be known to Ohio Farmers. Surely, the type of "contract" contemplated by Prudential's Endorsement No. 3 is a contract relating specifically to the underlying policy upon which the entire policy of Prudential is based. Surely, it contemplated an endorsement to that very policy, which is precisely what occurred.

IV.

CORRECTION OF OTHER ERRORS OR MISSTATEMENTS IN OPPOSING BRIEFS NOT HERETOFORE COVERED.

At the bottom of page 1 of its brief, Prudential says, by way of preliminary statement, that the purpose of the judgment in declaratory relief was to determine the rights, duties and obligations of the parties under their respective insurance policies "to discharge a judgment against Louis Stores, Inc., the assured under said policies. . . ." This statement is patently incomplete. The declaration sought concerned the respective obligations to pay any liability that may be assessed against Louis Stores, Inc., *and its employees*, as indicated by paragraph V of the first amended complaint in declaratory relief, R. 4.

At page 5 of its brief, Prudential says, in the middle of said page, that the “courtesy boy” put the box of distilled water, over which Mrs. Christensen tripped, in the aisle against the shelf or “gondola”; Prudential errs. It was Land himself who pushed the box up against the shelf or “gondola” and left it there, as plainly indicated by Land’s testimony, referred to at length in appellant’s opening brief, especially Land’s testimony 8:8. Farther down in the same page of its brief, page 5, Prudential implies that all Land did was to follow instructions. The statement, at best, is incomplete. It is clear from the testimony of Land and Correia that Land was instructed never to leave a single box in the aisle below eye level, and it was precisely because he did not follow such instructions that the accident happened and Land was held liable.

At the top half of page 8 of its brief, Prudential believes it is clear that the judgment below must be affirmed, unless *both* of the findings questioned are erroneous. Prudential errs. If this Court should find, in its wisdom, that (1) appellees under their policies are obligated to discharge Land’s tort obligation, but (2) that Louis Stores, Inc., was somehow independently negligent, and actively negligent, along with Land, and this Court were to make such declaration, then we should have a situation of joint tort-feasors. Between joint tort-feasors, there is no right of contribution under the law of California, *Smith v. Fall River Joint Union High School District*, 1 Cal. 2d 331, 34 P. 2d 994. In such a situation, therefore, the State Court

judgment creditor would be free to seek satisfaction of judgment against whichever tort-feasor or whichever set of carriers she chose.

At page 37 of Prudential's brief, and at pages 22-23 of Ohio Farmers' brief, reference is made to *American President Lines, Ltd. v. Marine Terminals Corp.*, 234 F. 2d 753. As a preliminary matter, appellant asks this Court to consider all applicable law in a declaratory relief case, just as it asked the District Court below. It could not, however, have asked the District Court below to consider this particular precedent, inasmuch as it was not yet printed. The opinion below is dated April 20, 1956, and the precedent in 234 F. 2d 753 is dated June 14, 1956.

Appellees also seek to distinguish the *American President Lines* case on the ground that it rested purely on the contract between the parties involved. It is true that the Court stated it preferred so to rest its decision. The Court also said, however, that the doctrine of passive versus active negligence applied. As this Court said at 234 F. 2d 757:

"In the instant case the Court below found that 'the plaintiff's negligence was passive and that the defendant continued to work with the knowledge of the dangerous condition of the defective strongbacks.'

Under these views it would appear that American being guilty of passive negligence could recover indemnity from Marine because of its active and primary negligence in permitting the work to continue under known unsafe conditions."

The Court went on to say that it preferred to rest its decision upon another ground only because a question of statutory construction of the Longshoremen's and Harbor Workers' Compensation Act would be left open under the passive and active negligence ground.

CONCLUSION.

Appellees are obligated under their policies to discharge the State Court judgment against Clifton Land. Hence, he is an "insured" under their policies, whether or not they choose to call him such; for the term "insured" represents a legal conclusion.

Appellant has proved that the State Court trier of fact found Clifton Land negligent and that therefore his employer Louis Stores, Inc., was also held liable on the theory of *respondeat superior*. Appellees have failed to show any evidence of any other basis of liability on the part of Louis Stores, Inc. Correia, the store manager who instructed Land and who decided how many people would be on duty at the time in question, was exonerated of negligence by the jury. In any event, Clifton Land's negligence was active, and the negligence of Louis Stores, if any, was passive. Hence, the judgment of the District Court should be reversed and the rights and obligations of the parties to this proceeding should be declared as follows:

(1) Defendants-appellees are obligated under their respective policies to pay the liability assessed

against Clifton Land in the Alameda County Superior Court action; and

(2) The liability of Clifton Land and his insurers is primary to that of Louis Stores, Inc., and its insurers; so that the latter are entitled to indemnity.

Dated, San Francisco, California,

May 1, 1957.

Respectfully submitted,

EDWARD A. FRIEND,

Attorney for Appellant.

No. 15,335

United States Court of Appeals
For the Ninth Circuit

THE CANADIAN INDEMNITY COMPANY,
a corporation,

Appellant,

vs.

OHIO FARMERS INDEMNITY COMPANY, a
corporation, PRUDENTIAL ASSURANCE
COMPANY LIMITED OF LONDON, and all
other underwriters at Lloyd's Lon-
don subscribing to Lloyd's Policy
No. EB32914-C,

Appellees.

APPELLANT'S PETITION FOR A REHEARING.

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FILED

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APPELLANT'S PETITION FOR A REHEARING.

*To the Honorable William Denman, Walter L. Pope
and Richard H. Chambers, Judges of the United
States Court of Appeals:*

Appellant The Canadian Indemnity Company here-
by petitions for a rehearing under Rule 23 of this
Court upon the grounds enumerated herein.

I. THE OPINION OF THIS COURT, IN ITS DISCUSSION OF THE ALAMEDA ACTION, FAILS TO CONSIDER THE QUESTION OF PROXIMATE CAUSE.

Whenever a suit is filed for tortious negligence, it is basic that two things must be proved in order to secure a judgment against the alleged tortfeasor:

(1) That the tortfeasor was negligent toward the plaintiff; and

(2) That such negligence was a proximate cause of the accident or injury.

1 Witkin, Summary of California Law, p. 724, Negligence Par. 175.

If either of these two items be lacking, and if, nevertheless, liability is imposed, then such liability must be vicarious.

Land was held liable. No charge of vicarious liability was made against Land. Hence, both of these items must have been proved as against Land.

Correia was exonerated. This necessarily means that either (1) Correia was not negligent; or (2) even if Correia was negligent, his negligence was *not* a proximate cause of this accident.

It is submitted that there was no possibility of holding Correia vicariously liable—the pleadings contained no allegation of vicarious liability on the part of Correia.

Hence, appellant respectfully takes issue with the Court's statement at page 8 of its opinion: "If negligence had been attributed to Correia, it probably would have been *respondeat superior* negligence, be-

cause he was not at the store when the injury occurred and had no affirmative part in the sequence of placing the stumbling block in Mrs. Christensen's way." No *respondeat superior* negligence was alleged against Correia, and hence it could not have been found.

The opinion of this Court continues at page 8,

"We suspect the jury may have thought Correia didn't have enough authority to keep adequate help on the job to keep temporary obstructions out of the aisles. It may have thought the safety instructions he had passed on to employees went only through him as a conduit from top management."

Appellant submits that no reason exists for this Court to assume that Correia testified untruthfully; a witness is presumed to speak the truth. He testified as follows at page 9 of his testimony, lines 9-15:

"Q. Who would make the decision as to how many employees were warranted to run that store from seven to nine?

A. I would.

Q. In your judgment, when you left the store you felt, I take it, that one clerk and one courtesy boy could manage all the needs of the store for those two hours?

A. That's right."

Since Correia, as store manager, made the decision concerning how many people would be on duty from seven to nine of that particular Friday evening, the following conclusion follows: Either (1), having so few employees on duty at that time was not negligent,

or (2), even if having so few employees there at that time was negligent, such negligence was not a proximate cause of the accident. The exoneration of Correia does not make sense on any other hypothesis. It is precisely because of his absence at the time of the accident that a verdict against him, had it been returned, would have to be based on his decision that one clerk and one courtesy boy were enough for those two hours on Friday night. The whole case against Correia was based upon that decision by him.

It is submitted that this case does not turn on the general personnel policies or the over-all company policies of the corporate defendant. This case turns on the leaving of a single box in an aisle shortly after seven o'clock, bearing in mind that the aisles were all clear shortly before seven, when Correia went home. The proximate cause of this accident must be related to that particular box.

Consider the matter of safety instructions. It appears at page 10 of Correia's testimony that he had instructed Land *not* to leave a box in the aisle below eye level, where customers might be damaged by it. It appears at page 6 of such testimony that Correia had been told that repeatedly by his own superior. The instructions were perfectly good. This accident occurred because the instructions were violated by Land. It is true, of course, that Land said his "primary duty" was the checking out of customers at the cash register, but there is no inconsistency between the "primary duty" and the safety instructions. With no violence at all to his "primary duty," he could have

followed the safety instruction in any one of several ways: He could have put the other five bottles on the shelf in fifteen seconds, he could have asked Donald Nolan to take the box back out to the storeroom, or he could have taken the box up front with him to the cash register. It was his very failure to follow the safety instruction which is co-extensive with his negligence in this case; and his negligence has been proved.

If adequate safety instructions were given, and if the lack of help was not a proximate cause, then the liability of the corporation must have been derivative. A *respondeat superior* allegation was made, R. 34, and a *respondeat superior* instruction was given, R. 25. Hence, it is submitted that at the very least appellant has made a *prima facie* case that the judgment against it in the Alameda action was based upon *respondeat superior*, and it has not been shown to have been based upon anything else.

II. THE QUESTION OF WHETHER APPELLEES MUST SATISFY THE JUDGMENT RENDERED AGAINST LAND IS A SIGNIFICANT POINT REGARDLESS OF RESPONDEAT SUPERIOR AND THIS COURT OUGHT TO PASS ON IT.

Appellant sought by its complaint in declaratory relief to learn what carrier or carriers must satisfy the judgment rendered against the corporation and against its employees in the Alameda action. Even assuming joint negligence by independently liable tortfeasors, the question has not been completely answered.

Both the District Court and this Court have held that all policies involved in this case insure Louis Stores, Inc. No one has ever contended that Canadian insured Land. The opinion of this Court intimates that appellees *are* obligated to pay the liability assessed against Land, but yet this Court does not specifically pass upon this question.

The holding of this Court, it is submitted, comes to this: If Virginia Christensen makes demand upon Louis Stores, Inc., that it pay the Alameda judgment, then Canadian and Ohio Farmers must respond in a ratio of ten to one.

But suppose Virginia Christensen, as is equally her right, makes demand upon Clifton Land that he pay the Alameda judgment. Must not Ohio Farmers and Prudential then respond to the limits of their respective coverage? This Court in its opinion intimates that the answer to that question is in the affirmative. At page 2 of the opinion, this Court says that Prudential was on the risk covering Land to the same extent as was Ohio. At page 3 of its opinion, this Court says that Land had some protection under the Ohio policy. It is admitted that Ohio defended Land under its policy. At page 9 of its opinion, this Court says: "Wouldn't a California court make Ohio and Prudential pay Mrs. Christensen even though Louis Stores, Inc., was indifferent about the whole matter?" Appellant believes that clearly a California court would, and that is true regardless of whether Louis Stores, Inc., was in or out of the state. There is no

contribution among joint tort feasons, and a judgment creditor may pursue whichever one she chooses; this point is made, with citation of authority, at page 22 of appellant's reply brief, second paragraph.

(It is interesting to note that the law of California concerning joint tort feasons has recently been changed and there now is a right of contribution, California Code of Civil Procedure 875-880. If this law had been in effect at the time the Alameda action arose, its meaning would be as follows: With respect to one-half of the judgment, Canadian would have to pay ten-elevenths and appellees one-eleventh; with respect to the other half of the judgment, appellees would have to pay it *in toto*. Thus, Canadian would have to pay five-elevenths of the total judgment and appellees six-elevenths of the total judgment. That law, however, applies only to causes of action accruing on and after the first of January, 1958.

With reference to this tort, which occurred in 1955, there is no right of contribution among joint tort feasons and the judgment creditor may proceed against whichever judgment debtor or insurance carriers she chooses. It is not incumbent upon her to select the larger or the wealthier judgment debtor. If the pre-1958 California law on joint tort feasons was a jungle, it was one in which these parties had to dwell.)

No Court will ever be in a better position than this Court is now to answer the question of whether appellees are obligated to discharge the liability assessed

against Land in the Alameda action. It is a significant question and it is part of the declaration sought. This Court should pass upon it.

III. THERE IS A PATENT INCONSISTENCY BETWEEN THE HOLDING OF THIS COURT AND THE JUDGMENT WHICH IT AFFIRMS.

The judgment of the District Court appears at R. 57-59. It contains five paragraphs. Paragraphs 1, 2 and 3 thereof are affirmed by the opinion of this Court.

Paragraph 4 of the District Court's judgment, however, at R. 58, is affirmed only in part by the opinion of this Court. Paragraph 4 of said District Court judgment says that Land was not an insured under any of the policies of insurance issued by plaintiff or by defendants and is not entitled to enforce the provisions of any said policies. This Court agrees, at page 2 of its opinion, that Canadian's policy has no employees' endorsement although the Ohio policy does have such an endorsement.

At page 9 of its opinion, however, this Court specifically declines to decide the point of whether or not Land was insured. Yet, this Court affirms the judgment of the District Court. Hence, it is submitted, a patent inconsistency exists between the judgment of this Court and the judgment below. This Court, if it declines to make a holding on appellees' responsibility with reference to the liability assessed against

Land, should, at the very least, vacate or modify, if not reverse, part of paragraph 4 of the judgment rendered below.

Dated, San Francisco, California,
February 3, 1958.

Respectfully submitted,
EDWARD A. FRIEND,
*Attorney for Appellant
and Petitioner.*

CERTIFICATE OF COUNSEL

I hereby certify that in my judgment this petition for a rehearing is well founded and it is not interposed for delay.

Dated, San Francisco, California,
February 3, 1958.

EDWARD A. FRIEND,
*Attorney for Appellant
and Petitioner.*

No. 15,337

IN THE

United States Court of Appeals
For the Ninth Circuit

CENTENNIAL INSURANCE COMPANY, a
Corporation,

Appellant,

VS.

DAVE SCHNEIDER, Doing Business as
Dave Schneider Wholesale Jewelry,
Appellee.

APPELLANT'S OPENING BRIEF.

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FILED

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No. 15,337

IN THE

**United States Court of Appeals
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CENTENNIAL INSURANCE COMPANY, a
Corporation,

Appellant,

vs.

DAVE SCHNEIDER, Doing Business as
Dave Schneider Wholesale Jewelry,

Appellee.

APPELLANT'S OPENING BRIEF.

This is an appeal from a final judgment of the District Court of the United States for the Southern District of California, Central Division, Honorable Thurmond Clarke, Judge Presiding.

JURISDICTION.

The action was originally filed in the Superior Court of the State of California, in and for the County of Los Angeles, by Dave Schneider, a citizen of California, against Centennial Insurance Company, a New

York corporation. The amount in controversy was in excess of \$3,000.

Upon the petition of defendant, the action was removed to the District Court of the United States on the basis of the diverse citizenship of the parties.

The jurisdiction of the District Court was based upon sections 1332 and 1441 of Title 28 United States Code. The jurisdiction of this court is based upon section 1291 of Title 28 United States Code.

The petition for removal is found at page 3 of the transcript. The jurisdictional allegations are on pages 4 and 5. The notice of appeal is on page 38.

STATEMENT OF THE CASE.

Plaintiff (appellee) is a Long Beach wholesale jeweler. On August 15, 1954, defendant (appellant) issued to him a jewelers' block policy of insurance (plaintiff's Exhibit 1) the purpose of which was to insure his stock in trade.

The insured property was described as follows in the policy:

“(a) Pearls, precious and semi-precious stones, jewels, jewelry, watches and watch movements, gold, silver, platinum, other precious metals and alloys and other stock usual to the conduct of the Assured's business, owned by the Assured.”

In the course of selling to retail stores, plaintiff travels by car with jewelry of considerable value which he carries in two specially fitted cases (weigh-

ing approximately 65 pounds each and measuring $41\frac{1}{2} \times 21\frac{1}{2}$ feet x 20 inches (49-50)).¹

On December 3, 1954, the two cases and their contents were "lost" by plaintiff under the following circumstances:

Plaintiff left his place of business at approximately 10 A.M. (55). He called upon one retailer (55), had lunch (57) and then called upon another retailer (Bruce Jewelers) to whom he displayed the jewelry which he was carrying in the two cases (58). At 2:00 P.M., he put the cases back in the trunk of his car and locked it (58-59).

He then drove a distance of about two blocks to the Joy Jewelry Company (59), where, however, he did not display his merchandise (63). Instead, he drove around the block with Mr. Steltzer, one of the buyers, to an alley where Mr. Steltzer wanted to show him a newly purchased car (63-64).

Plaintiff parked his car behind Mr. Steltzer's car (66) and talked to him (in the driver's seat of Mr. Steltzer's car) for ten or fifteen minutes (68).

He adjusted the rear view mirror so as to be able to watch his car (68). He watched it only "off and on", however, as he was busy inspecting the interior of Mr. Steltzer's car and generally talking with

¹Unless otherwise indicated, all references will be to pages of transcript. When preceded by the letter B, references will be to pages and lines of plaintiff's examination under oath (Defendant's Exhibit B).

him about it (68). Moreover, he testified that he could not see the back of his own car "very well" (68).²

Plaintiff then drove to the store of another customer, California Premium Service, located some four miles away (70-71). Because of the heavy traffic, it took him about 45 minutes to cover that distance and he arrived there at about 4:30 P.M. (70-71).³

It is there (after first talking to the owner, Mr. Nigro, in front of the store and inspecting a diamond in the store) that plaintiff discovered that the two cases were missing from the trunk of his car.

Plaintiff testified that he watched his car while talking to Mr. Nigro (81) and the latter testified that he watched it during the one minute during which plaintiff was examining the diamond (83-5; 123).⁴

Plaintiff further testified that he never saw the back of his car go up either while he was driving or while he was stopped for traffic (55, 60, 71-72); that he did not go to the bathroom during the approximately seven hours that elapsed between 10 A.M. (when he left his place of business in the morning) and the time when he discovered the loss (71); and that, on the two occasions when he was not actually in his car after 2:00 P.M. (namely, when he was visiting with Mr. Steltzer and when he was talking to Mr. Nigro

²When previously examined under oath by defendant as provided in the policy, plaintiff had simply testified that he could not see the back of his car (B 45:21-23).

³In his examination under oath, plaintiff had testified that that trip took him only 20 to 25 minutes (B 48:12-13).

⁴In his examination under oath, however, plaintiff had testified that it took him from two to three minutes to inspect the diamond (B 57:2-4).

and inspecting the diamond), he was closely watching the car himself (or was having it watched either by Mr. Steltzer or by Mr. Nigro).

In his examination under oath, plaintiff had unequivocally testified that the back of his car could not have been raised without his noticing it (B, 37:8-9). At the trial, however, he soft pedaled his testimony on the subject and stated that he was not actually watching the back of his car (71-72) and that, although he never saw it go up, he would not have seen it go up unless it had gone up all the way (55, 60, 72).

He further gave it as his opinion that the jewelry cases could be removed from the trunk if the lid were raised only twelve inches (72).

At the end of his examination under oath, plaintiff had testified as follows:

“Q. Let me ask you this. Can you explain how this loss occurred?

A. I haven't the slightest idea. If I had any idea of how it happened I would have stopped it.

Q. If you had been watching the car every minute of the day as you said you were how would the stuff have been removed?

A. I have had lots of sleepless nights on this myself, and I have woke up in the middle of the night trying to figure it out and I haven't the slightest idea of how it happened.

Q. It is unexplainable to you, then?

A. To me it is unexplainable.” (B, 66:15-67:1).

At the trial, plaintiff gave similar testimony as, for example, the following:

“Q. As a matter of fact, the loss of these cases is completely unexplainable to you; isn’t that so?

A. Yes, sir; it sure is.

Q. Did you tell the police, immediately after you discovered the loss, that you really didn’t know where it happened?

A. Yes, sir.

Q. And is that the fact?

A. I still don’t know where it happened.”
(73)

He also gave it as his opinion, however, that the jewelry could only have been stolen while he was travelling or was stopped for traffic between Mr. Steltzer’s store and the California Premium Service Store (72, 101). The trial judge granted one motion to strike that testimony (102) but denied another (72).

To complete the picture, it should be noted that no evidence was found of any tampering with the lock of the trunk (87).

Plaintiff filed this action to recover under the policy alleging that the loss, which he valued at \$26,274.51, was covered thereunder.

As far as material to this case, the policy provided as follows:

“5. This policy insures against all risks of loss of or damage to the above described property arising from any cause whatsoever except:

* * * * *

“(I) Loss or damage to property insured hereunder while in or upon any automobile, motorcycle or any other vehicle unless, at the time the loss occurs, there is actually in or upon such vehicle, the Assured, or a permanent employee of the Assured, or a person whose sole duty it is to attend the vehicle. This exclusion shall not apply to property in the custody of a carrier mentioned in Section 2 hereof, or in the custody of the Post Office Department as first class registered mail.”

* * * * *

“(M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory. Nor shall this policy cover any shortage in goods claimed to have been forwarded in a package when the package is received by the consignee in apparent good order with seals unbroken; nor for loss of or damage to goods when sent ‘C.O.D.’ with the privilege of inspection by the consignee before delivery.”

Defendant filed an answer (12-19) in which it denied coverage under the policy and affirmatively alleged that the loss was expressly excluded both by clause 5 (I) and by clause 5 (M). Defendant further affirmatively alleged that plaintiff was in any event precluded from recovering because of his failure to maintain an inventory of the lost merchandise as required by the following provision of the policy:

“8. It is a condition of this insurance that:
(A) The Assured will maintain a detailed and itemized inventory of his or their property and separate listing of all travelers’ stocks, in such manner that the exact amount of loss can be accurately determined therefrom by the Company.”

With the exception of brief testimony from Mr. Steltzer and from Mr. Nigro, plaintiff was the only witness at the trial.

The trial court found that the jewelry was stolen while plaintiff was actually in his automobile, and that the loss was neither an unexplained loss nor a mysterious disappearance within the meaning of the policy. The trial court further found that plaintiff did maintain an inventory of his property as required by the policy.

The following are the material findings of fact and conclusions of law:

Finding III.

“That it is true, as alleged in paragraph III of plaintiff’s complaint, that on the 15th day of August, 1954, for a valuable consideration paid by plaintiff to defendant, the defendant made, entered into, executed, issued and delivered to plaintiff a contract of insurance under which defendant agreed to pay plaintiff for any loss of or damage to jewelry and other property of the plaintiff which should occur within one year from August 15, 1954.”

Finding VII.

“That it is true, as alleged in paragraph VI of plaintiff’s complaint, that on the 3rd day of December, 1954, the plaintiff suffered and sustained a complete and total loss of that certain jewelry of the value of \$25,360.01 and those certain sample cases and trays of the value of \$914.50; and that such loss occurred by reason of the theft of such property in the County of Los Angeles, State of

California. That the plaintiff's jewelry and sample cases and trays were stolen from the trunk of plaintiff's automobile at a time when the plaintiff was in such vehicle."

Finding XI.

"That it is true that plaintiff's jewelry and sample cases and trays were stolen from plaintiff's automobile, but it is not true, as alleged in the so-called 'Third Defense' of defendant's answer that said jewelry and sample cases and trays were taken 'at a time when neither the assured (the plaintiff) nor a permanent employee of the assured nor a person whose sole duty it was to attend the vehicle, was actually in or upon such vehicle.'"

Finding XIII.

"That it is not true, as alleged in the so-called 'Fourth Defense' of defendant's answer, that plaintiff's loss was an unexplained loss or mysterious disappearance, and it is not true that plaintiff's loss was an 'unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory.'"

Finding XV.

"That it is not true, as alleged in the so-called 'Fifth Defense' of defendant's answer, that the plaintiff did not maintain a detailed and itemized inventory of his property as provided in the clause quoted in said so-called 'Fifth Defense.'"

* * * * *

Conclusion II.

"That the plaintiff's loss was not excluded from coverage under the contract of insurance in

question by reason of the matters set forth in the so-called 'Third Defense' of defendant's answer."

Conclusion III.

"That the plaintiff's loss was not excluded from coverage under the contract of insurance in question by reason of the matters set forth in the so-called 'Fourth Defense' of defendant's answer."

Conclusion IV.

"That plaintiff's loss was not excluded from coverage under the contract of insurance in question by reason of the condition set forth in the so-called 'Fifth Defense' of defendant's answer."
(26-31.)

The trial court accordingly gave judgment for plaintiff in the amount of \$15,914.50, \$15,000 representing defendant's maximum liability under the policy for a jewelry loss which occurred in an automobile and \$914.50 representing the value of plaintiff's sample cases and trays.

SPECIFICATION OF ERRORS.

(1) The trial court erred in finding that, under the policy which it issued to plaintiff, defendant agreed to pay for "any loss of or damage to jewelry and other property of the plaintiff" (Finding III) and in concluding that the loss, if any, sustained by plaintiff was covered by the policy.

Finding III is erroneous for the reason that the policy does not insure "any loss" to the jewelry of plaintiff. The policy insures against "all risks of loss . . . from any cause whatsoever except:". This loss was excluded under clause 5 (I) and clause 5 (M) of the policy.

(2) Assuming, but not conceding, that plaintiff's jewelry, sample cases and trays were stolen from the trunk of his automobile, the trial court erred in finding and concluding that plaintiff was in his automobile at the time when they were stolen (Finding VII and XI, Conclusion II).

Findings VII and XI and Conclusion II are erroneous for the reason that the record contains no evidence to support them.

(3) The trial court erred in finding and concluding that plaintiff's loss was not an unexplained loss or a mysterious disappearance within the meaning of the policy (Finding XIII, Conclusion III).

Finding XIII and Conclusion III are erroneous for the reason that plaintiff's loss was an unexplained loss or a mysterious disappearance within the meaning of the policy.

(4) The trial court erred in finding and concluding that plaintiff maintained an inventory of his property as required by the policy (Finding XV, Conclusion IV).

Finding XV and Conclusion IV are erroneous for the reason that the evidence affirmatively shows that plaintiff did not maintain the inventory required by the policy.

SUMMARY OF THE ARGUMENT.

- (1) The Finding That the Jewelry Was Stolen While Plaintiff Was in His Automobile Is Completely Unsupported by the Evidence, for Plaintiff's Testimony on the Subject Must Be Rejected as Inherently Incredible. The Loss Simply Could Not Have Happened as Plaintiff Claims That it Must Have Happened.
- (2) The Burden Rested Upon Plaintiff Not Only to Prove That He Was in His Automobile When the Loss Occurred But to Explain the Circumstances Under Which it Occurred.
- (3) The Loss Was Also Excluded as an Unexplained Loss or a Mysterious Disappearance of the Jewelry.
- (4) Recovery Should in Any Event Have Been Denied Plaintiff Because of His Failure to Maintain the Necessary Inventory.

ARGUMENT.

- (1) **THE FINDING THAT THE JEWELRY WAS STOLEN WHILE PLAINTIFF WAS IN HIS AUTOMOBILE IS COMPLETELY UNSUPPORTED BY THE EVIDENCE, FOR PLAINTIFF'S TESTIMONY ON THE SUBJECT MUST BE REJECTED AS INHERENTLY INCREDIBLE. THE LOSS SIMPLY COULD NOT HAVE HAPPENED AS PLAINTIFF CLAIMS THAT IT MUST HAVE HAPPENED.**

The trial court was faced, as this court is now faced, with a situation in which, if plaintiff's testimony is taken at face value, the two cases of jewelry disappeared under mysterious and unexplained circumstances. At 2 P.M., he locked them in the trunk of his car. Two and a half or three hours later, they were

gone despite the fact that, during the entire period, he either was in the car or was watching it or was having it watched by someone else.

Two cases of jewelry as large and cumbersome as plaintiff's cases do not simply evaporate into thin air. Something must have happened to them and the most logical conclusion is indeed that which the trial court reached, namely, that someone stole them.

It is our contention, however, that no one could have stolen them or, at least, that no one could have stolen them without being noticed if plaintiff had been at all times in or near his car as he claims that he was.

It is accordingly our contention that plaintiff's testimony cannot be taken at face value and that the "loss" must have occurred while he was away from his car, for it cannot have occurred while he was in his car.

To the extent therefore that it would support an inference that the jewelry was stolen while he was in his car, plaintiff's testimony must be rejected as inherently incredible. To the extent that he purported to rely on that testimony to find that the jewelry was stolen while plaintiff was in his car, the findings of the trial judge must be held to be altogether unsupported by the evidence.

Plaintiff contends that the loss must have happened while he was in the car because, so he contends, it cannot have happened at any other time. Our position is that the loss cannot have happened while he was in the car and that it accordingly must be held to have happened while he was away from it.

It is of course settled that, if the loss occurred at such a time, it was not covered by the policy.

We know of no California case construing a clause similar to clause 5 (I) in a jewelers' block policy. A comparable clause is found, however, in automobile liability policies which afford medical payments coverage to persons injured while "in or upon" the automobile. The case of *Christoffer v. Hartford Acc. etc. Co.*, 123 Cal. App. 2d Supp. 979, 267 P. 2d 887, makes it clear that, under the most liberal construction that can be given such a clause, there must be some actual physical contact between the automobile and the injured person.

There is no reason to assume that California courts would construe the clause differently in a jewelers' block policy. In fact, the clause has been given such a construction in all the cases from other states dealing with jewelers' block policies.

The leading case on the subject is *Ruvelson v. St. Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50 NW 2d 629, decided in 1951 by the Supreme Court of Minnesota. The policy involved in that case insured the property of a wholesale jeweler against loss or damage "arising from any cause whatsoever". It also contained an exclusion clause which, except for one immaterial difference in spelling, was word for word the same as clause 5 (I).

The assured became sick while traveling and left his car for two minutes to go to the restroom and buy a cup of coffee. During that time, his jewelry was stolen.

The court held that the loss was not covered by the policy since it occurred without the actual presence in or upon the car of a person who was in charge of the jewelry. The case is so clearly in point that we deem

it necessary to quote at length from the opinion in an appendix to this brief.

To the same effect, see also:

Dreiblatt v. Taylor, 67 N.Y.S. 2d 378;

Greenberg v. Rhode Island Ins. Co., 66 N.Y.S. 2d 457;

Kinscherf v. St. Paul Fire & Marine Ins. Co., 254 N.Y.S. 382;

Princess Ring Co., Inc. v. Home Ins. Co., 52 R.I. 481, 161 Atl. 292;

Bliss Ring Company v. Globe and Rutgers Fire Ins. Co., 7 Ill. App. 2d 523, 129 N.E. 2d 784.

If it is supported at all, the finding of the trial judge must be supported by plaintiff's testimony that he put the two cases in the trunk of his car at 2 P.M., that no theft occurred while he was in Mr. Steltzer's car, that no theft occurred while he was in Mr. Nigro's store and that it accordingly must have happened while he was in his car.

In other words, it is plaintiff's contention that, either while he was driving bumper to bumper with other cars or while he was waiting for traffic between the Joy Jewelry Company store and that of California Premium Service, someone came to the rear of his car, opened the trunk compartment (presumably with a key which the thief had previously obtained since there apparently was no tampering with the lock of the trunk), raised the lid sufficiently to remove the jewelry cases and shut the trunk again.

It must be remembered that each case weighed 65 pounds and measured $4\frac{1}{2}$ feet by $2\frac{1}{2}$ feet by 20 inches. Plaintiff never explained how a case of that size could be removed from the trunk of his car by raising the

lid only 12 inches. Yet, he unhesitatingly testified that it would have been enough for the thief to raise it 12 inches to remove the cases.

It is our contention that the cases could not be removed from the trunk of the car without his noticing it. Nor could they be removed therefrom while he was in the middle of heavy traffic without the theft being noticed and brought to his attention by one of the many drivers who surrounded him.

The loss simply could not have happened under the circumstances under which plaintiff testified that it must have happened and his testimony to that effect must accordingly be rejected as inherently incredible.

(2) THE BURDEN RESTED UPON PLAINTIFF NOT ONLY TO PROVE THAT HE WAS IN HIS AUTOMOBILE WHEN THE LOSS OCCURRED BUT TO EXPLAIN THE CIRCUMSTANCES UNDER WHICH IT OCCURRED.

Plaintiff contended at the trial and will undoubtedly contend again on appeal that defendant had the burden of proving not only that the loss occurred while the jewelry was in the automobile but that it occurred while plaintiff was *not* in the automobile.

It is our position that, under clause 5 (I), defendant merely had the burden of proving that the loss occurred while the jewelry was in the automobile. Thereafter, the burden rested on plaintiff to prove that the loss was nevertheless covered by the policy.

We recognize that, in a policy of this type, the burden of proving that a loss is excluded rests upon the

insurance company. Thus, since the policy in this case excluded losses occurring while the jewelry was in an automobile, the burden was on defendant to establish (by its testimony or by that of plaintiff) that the loss occurred while the jewelry was in an automobile.

In order to recover despite that fact, it was then up to plaintiff to establish that he was *actually* in or upon the automobile at the time of the loss. It is *only* in such a case that he could bring himself back within the coverage of the policy. The burden was upon him (it could be on no one else) to prove that his loss came within the exception to the already established exclusion.

Moreover, since unexplained losses and mysterious disappearances are excluded under another clause of the policy, the requirement that the insured be in or upon his automobile at the time of the loss can only be construed as a requirement that *he* be able to explain how an automobile loss occurred and the policy itself must be held to cover only those automobile losses which he can explain.

Thus, in this case, having failed to explain when and how the theft occurred, plaintiff must be held to have failed to sustain the burden which was his under the policy.

Although we found no case dealing with the question of the burden of proof under an automobile exclusion clause such as is involved in this case, there is very persuasive California authority in support of the contention that the burden was upon plaintiff to prove

that he was in or upon his automobile at the time of the loss.

In *Rossini v. St. Paul Fire, etc. Ins. Co.*, 182 Cal. 415, 188 Pac. 564, the plaintiff sued on a fire policy which provided in part as follows:

“This company will not be liable for loss * * * unless fire ensues (and in that event for damage by fire only), by explosion or any kind of lightning.”

In the course of its opinion, the court announced the following rule in connection with the burden of proof under that clause:

“The burden of proof under the ‘explosion exemption’ clause of contracts of insurance devolves as follows: There having been shown the execution of a contract, the occurrence of a fire with a resulting loss, and notice to the insurer, if the insurance company claims exemption by reason of the breach of a proviso or condition subsequent, the burden rests upon the company to prove that a loss, or part thereof, falls within one of the prohibitive clauses of the policy. In other words, the company must plead and prove the exception or breach which it sets up as defeating plaintiff’s *prima facie* right of recovery. If such burden is sustained and the case proved, for example, to be within the explosion exemption clause by a showing that the explosion occurred first in point of time, plaintiff is then called upon to prove the extent of damage, if any, suffered from the subsequent and resulting fire.” (182 Cal. at page 420)

Similarly, in this case, once it was established that the loss was within the automobile exclusion clause,

plaintiff was called upon to prove that he was in or upon his automobile at the time of the loss.

In *Mauck v. Northwestern National Ins. Co.*, 102 Cal. App. 510, 283 Pac. 338, the plaintiff filed suit on a fire policy which provided in part as follows:

“This company shall not be liable for loss or damage occurring * * * while a building herein described * * * is vacant or unoccupied beyond the period of ten consecutive days.”

* * * * *

“If the building described hereunder is located within the *incorporated* limits of a city or town, permission is hereby granted for the same to remain vacant or unoccupied without limit of time.”

In affirming a judgment for the insurance company, the court stated the following:

“The vacancy of the house having been established, the burden rested on the plaintiff to show that his grantors and assignors were relieved from the obligation imposed by the vacancy clause of the policy by virtue of the fact that the house was located within an incorporated city or town; that it remained vacant by written permission of the insurer or for any other legally excusable cause.”
(102 Cal. App. at page 515)

Similarly, in this case, the occurrence of the loss “in an automobile” having been established, the burden rested upon plaintiff to show that it was nevertheless covered under the policy.

(3) THE LOSS WAS ALSO EXCLUDED AS AN UNEXPLAINED LOSS OR A MYSTERIOUS DISAPPEARANCE OF THE JEWELRY.

There would be no coverage under the policy even though plaintiff was in or upon his car at the time when the jewelry disappeared since, according to his own testimony, it disappeared under mysterious and unexplained circumstances. The loss would then be excluded by clause 5 (M) which, as far as material, provides that neither an "unexplained loss" nor a "mysterious disappearance" is covered by the policy.

That clause is plain and unambiguous. A mysterious disappearance is defined in 27 Words and Phrases (1956 Pocket Part, page 222) as a disappearance occurring in an unexplained, unaccountable or unknown manner under puzzling or baffling circumstances. If plaintiff's testimony is taken at face value, the loss was unexplained and the disappearance mysterious.

Hence, whether the trial court chose to believe or not to believe his testimony, the result should have been the same. In either case, there was no coverage under the policy.

Although we were unable to find a case construing a mysterious disappearance clause under a jewelers' block policy, there are a number of cases involving theft policies in which courts have had occasion to construe the terms. The authorities are reviewed in *Casey v. London & Lancashire Indemnity Co.*, 126 N.Y.S. 2d 726, a 1953 New York trial court decision. In the course of its opinion, the court quoted as follows from two earlier decisions:

“The words ‘mysterious disappearance’ mean a disappearance that is mysterious. The adjective ‘mysterious’ modifies the noun ‘disappearance.’ ‘Mysterious’ means unknown, unaccountable, unexplainable. Therefore, a ‘mysterious’ disappearance is a *disappearance* which is unexplainable, unaccountable, or in an unknown manner.”

* * * * *

“Property is ‘lost or mislaid’ if a person cannot remember where he placed the article and therefore cannot find it. In such a case, there is no mysterious disappearance. It might have been stolen, but the presumption of theft in the policy would not apply because those facts do not establish that the property has disappeared mysteriously. However, assume that a person *remembers* where he placed the article. If it is not in its place when he attempts to recover it, it has disappeared in a mysterious (unknown) manner. The disappearance or vanishment *from its place* is unknown and unexplainable.” (126 N.Y.S. 2d at page 728.)

“So then a mysterious disappearance within the meaning of the policy embraces any disappearance or loss under unknown, puzzling or baffling circumstances which arouse wonder, curiosity, or speculation, or circumstances which are difficult to understand or explain. A mysterious disappearance is a disappearance under circumstances which excite, and at the same time baffle, wonder or curiosity. Webster, New Int. Dic.” (126 N.Y.S. 2d at page 729.)

It is immediately apparent that the foregoing definitions perfectly fit the facts of this case. Plaintiff remembered that he placed the jewelry in his automo-

bile. It was not in its place, however, when he attempted to recover it. It had disappeared in a mysterious or unknown manner. The disappearance or vanishment *from its place* was unknown and unexplainable. It was a disappearance under circumstances which certainly were baffling and certainly excited wonder or curiosity.

It seems clear that, had plaintiff simply testified that he did not know how his jewelry disappeared (without claiming that it disappeared from an automobile), he would have been denied recovery because of the mysterious disappearance exclusion.

The fact that, in addition to testifying that he did not know how the loss occurred, he also testified that it occurred while the jewelry was in an automobile should not place him in a stronger position.

Recovery should be denied on two grounds (automobile exclusion and mysterious disappearance exclusion) rather than just on one ground (mysterious disappearance exclusion).

It must be remembered that we are dealing not only with high value merchandise which is easily stolen but with a policyholder who, like all traveling jewelers, is a target for thieves. Hence it is not surprising that the insurance company should be willing to pay only for those losses which the policyholder can explain.

Nor is it surprising that it should be willing to pay for an automobile loss only in those instances in which such a loss occurred despite the presence of the policy

holder in or upon the automobile. His presence is intended to serve as a deterrent. If it fails as such a deterrent, the company will pay. It should not be made to pay, however, if there was no deterrent at all.

(4) RECOVERY SHOULD IN ANY EVENT HAVE BEEN DENIED PLAINTIFF BECAUSE OF HIS FAILURE TO MAINTAIN THE NECESSARY INVENTORY.

Moreover, there is a further complete defense to plaintiff's claim.

Plaintiff was required by clause 8 of the policy (as "a condition of this insurance") to "maintain a detailed and itemized inventory of his property and separate listing of all travelers' stocks, in such manner that the exact amount of loss can be accurately determined therefrom by the Company."

At the trial reference was made to three separate inventories or listings.

One of them, given to the police immediately after the loss (91), admittedly covered merchandise other than that which plaintiff was carrying and obviously fails to comply with the requirements of clause 8.

Another inventory or listing was prepared by plaintiff *after* the loss to be submitted to defendant in support of this claim (93-94). It is similarly insufficient since clause 8 obviously calls for an inventory or listing prepared before the loss.

Finally, plaintiff stated in his examination under oath that he had in his possession another inventory

or listing (prepared *before* the loss) which he would make available to defendant. The examination under oath took place on March 17, 1955. On April 29, 1955, without producing any inventory or listing, plaintiff added two pages to his testimony (92-94). They speak for themselves and we quote them at length:

“Amended Statement made by Dave Schneider on April 29, 1955.

With reference to my statements with reference to inventories of my merchandise, contained on pages 16 to 22, inclusive, of the attached Reporter's Transcript, I stated I could produce a copy of the inventory that I had of the merchandise I took up to Northern California with me in about the month of October, 1954, and which was the last previous long out-of-town trip that I took prior to the loss on December 3rd, 1954, but immediately after this statement was completed at C. E. Knight's office, on March 17, 1955, I went back to my office to get the same so that Mr. Knight could make a photostatic copy, but upon my return to the office I could not find the same nor could any of my employees find the same, even though we made a very diligent search for it, and that it must have been misplaced or lost, and if I should hereafter find it, I will submit it to C. E. Knight or such other person you may designate in Long Beach, California, so that a copy of the same can be made for and delivered to the Centennial Insurance Company.

“In order to clarify the inventories now in the possession of said insurance company, the one that was submitted on or about December 3,

1954, at the time of the loss, and which was for the use of the police and/or said insurance company, is not an accurate inventory of the merchandise I lost on December 3rd, 1954, and the police and representatives of the insurance company were so informed by me, and was an inventory of the merchandise my salesman had in his two cases which was similar to the line of merchandise in my two cases that I had on the day of the loss, and I believe that said inventory of the salesman's two cases is now in the possession of said insurance company and was given to C. E. Knight at the time of the loss.

“The second inventory referred to is the one attached to my proof of loss made January 20th, 1955, which was prepared in connection with said proof of loss and shortly before the filing of said proof of loss with said insurance company, and this second inventory is a correct inventory of said loss that occurred on December 3rd, 1954, and was prepared by checking my books, records and merchandise.

“All my answers with reference to inventories contained in the Reporter's Transcript hereto attached, are correct, except as they are corrected and modified by the foregoing statement I now make on April 29th, 1955.

Dave Schneider”

It is our earnest contention that there never was any such inventory or listing. We simply cannot believe and we hope that this court will similarly find itself unable to believe in the mysterious disappear-

ance of the inventory on top of the mysterious disappearance of the jewelry itself.

Be that as it may, however, it is our contention that, even if it once existed or still exists, this inventory or listing which plaintiff cannot find is *not* a sufficient compliance with a clause which made it "a condition of this insurance" that plaintiff maintain a listing "in such a manner that the exact amount of loss can be accurately determined therefrom by the Company."

The policy did not merely require that plaintiff *maintain* such a listing. It required that he maintain it in such a way as to make it possible for defendant *to accurately determine the amount of the loss*. This of course can only mean that he was required to maintain the listing *before* the loss *and* to make it available to defendant *after* the loss.

In other words, the policy requires defendant to pay only those losses which it has had an opportunity to check against such an inventory.

No citation is needed (in fact we doubt that plaintiff will contend otherwise) in support of the proposition that plaintiff cannot recover in this action if he did not maintain an inventory or listing at all. The policy itself precludes recovery in such a case (in any event, see the cases cited in the annotations in 39 ALR 1443, 1445, and 125 ALR 350, 352; see also the cases cited in the annotation in 56 ALR 1086 which hold that a delay in the preparation of an inventory beyond the deadline fixed for that purpose by the policy (as for example, 30 days after the effective date of the policy) will avoid the policy).

Needless to say, if a delay in the preparation of an inventory is a sufficient breach to avoid the policy, a complete failure to prepare an inventory will have the same effect; hence, there could be no recovery by plaintiff in this case if plaintiff did not in fact maintain the inventory or listing which he claimed to be unable to find.

Even if plaintiff did prepare the necessary inventory or listing before the loss, however, there can be no recovery in this action since plaintiff failed to make it available to defendant and hence made it impossible for defendant to check the loss.

It may be that, if the inventory or listing had been stolen or destroyed by fire, plaintiff would be excused from producing it. But he certainly cannot be excused upon a mere showing that he no longer can find it.

CONCLUSION.

Plaintiff's loss was outside of the coverage of the policy.

Since he failed to prove that he was in or upon his automobile when the jewelry was stolen, coverage of the loss was excluded by the automobile exclusion clause of the policy.

Moreover, coverage was in any event excluded by the unexplained loss and mysterious disappearance clause of the policy.

Finally, recovery should have been denied plaintiff because of his failure to maintain the necessary inventory.

For the foregoing reasons, the judgment should be reversed.

Dated, San Francisco, California,

March 25, 1957.

Respectfully submitted,

GEORGE H. HAUERKEN,

HAUERKEN, ST. CLAIR & VIADRO,

Attorneys for Appellant.

(Appendix Follows.)

Appendix.



Appendix

RUVELSON v. ST. PAUL FIRE & MARINE INS. CO.,
235 Minn. 243, 50 N.W. 2d 629.

“Plaintiffs readily concede that Olson was not actually ‘in’ the car, but contend that the word ‘upon’ has a broader meaning and should be construed to be the substantial equivalent of ‘in proximity to,’ ‘in the neighborhood of,’ ‘in the presence of,’ or ‘in the charge of.’ * * *”

“We have not had occasion heretofore to construe the precise language in the insurance policy which we now have before us. Courts in other jurisdictions have uniformly construed this and similar language adversely to the contentions of plaintiffs.

“The case of *William Kinscherf Co., Inc. v. St. Paul Fire & Marine Ins. Co.*, 234 App. Div. 385, 386, 254 N.Y.S. 382, 383, involved an action on a similar insurance policy containing a clause excepting liability for ‘Loss or damage to property insured hereunder whilst in or upon any automobile, motorcycle or horse drawn vehicle unless such conveyance is attended at the time the loss occurs by a permanent employee of the assured. * * *’ Loss occurred while the car of plaintiff’s employee was parked at the curb, with doors and windows locked, and the employee called on a customer and had lunch. In denying recovery, the New York court said: ‘* * * Such language can only be interpreted to mean that if the permanent employee of the plaintiff is not actually within or on the automobile, or so near thereto as to be able to observe a theft of the contents, he shall not be deemed to be in attendance at the time the loss occurs.’

“In *Greenberg v. Rhode Island Ins. Co.*, 188 Misc. 23, 25, 66 N.Y.S. 2d 457, 459, we have an action on a similar policy excepting liability for ‘Loss or damage by theft and/or attempted theft from any unattended automobile or motorcycle, unless, at the time the loss occurs, there is *actually in or upon such vehicle* the Assured or a permanent employee of the Assured, or a person whose *sole* duty is to guard the property; * * *.’ The court commented upon the difference in language from the Kinscherf case, saying: ‘ * * * There was no requirement (in the Kinscherf case), as here, that at the time of the loss that the assured or his permanent employee or the person whose sole duty is to guard the property shall be *actually* in or upon the vehicle. “Actual” means that which exists in fact or reality, in contrast to that which is constructive, theoretical or speculative. * * *’

“The facts in the Greenberg case showed that the plaintiff (the insured), who had the jewelry in her possession had left it in the car with all the doors locked and had entered a restaurant. Prior to entering the restaurant, insured requested another party, a stranger standing near the car, to watch over it and promised to pay him a dollar for his services. Insured returned about an hour later and discovered that one of the doors had been pried open and that the property had been stolen. The court denied recovery, saying, 188 Misc. 26, 66 N.Y.S. 2d 459: ‘The language in exclusion clause (d) being clear and explicit, it is manifest that the loss falls within the exception and that no liability has attached to the defendant under the policy, and that plaintiff is not entitled to recover.’

“In *Dreiblatt v. Taylor*, 188 Misc. 199, 67 N.Y.S. 2d 378, which was an action on a policy with an exception clause similar to that in the Kinscherf case, the court adhered to that decision.

“In *Princess Ring Co., Inc. v. Home Ins. Co.*, 52 R.I. 481, 483, 161 A. 292, 293, a policy of insurance containing an exception in these words was involved: ‘ * * * loss or damage to property insured hereunder whilst in or upon any automobile * * * unless such conveyance is attended at the time the loss occurred by a permanent employee of the assured, or by a person whose sole duty is to attend the conveyance *and who at such time shall remain in or upon the conveyance.* * * * ’ (Italics supplied.)

“The employee of plaintiff to whose care the jewelry was entrusted stopped in front of an apartment house in which his brother lived, intending to take his brother with him to see a prospective customer. He parked his automobile within ten feet of the entrance to the apartment house where his brother lived, turned off the ignition, and left the key in the switch. He then asked his brother’s father-in-law, George Mark, who was sitting on a ledge watching his grandchild play, to watch the car while he went to ring the bell to summon his brother. He saw Mr. Mark lean against the car with his elbow inside the window, and walked about 40 feet into the courtyard. As he started to ring the bell he heard Mr. Mark call, and he ran out to his car and saw a strange man at the wheel. He ran around the front of the car and had one foot on the running board and his hand on the steering wheel when he was

pushed off and the car started, and the thief made away with the automobile. The court, in denying recovery, said, 52 R.I. 484, 161 A. 293: ‘ * * * The phrase “shall remain in or upon the conveyance” fixed the place where the person attending the automobile was required to be when the property insured was “in or upon any automobile.” The same phrase is used both in reference to the property insured and the person attending the automobile. Both must be “in or upon” the automobile. “Opportunity makes the thief.” If Mr. Mark had been in the automobile, probably the thief would not have entered.’ ”

* * * * *

“The language used in the exception now before us is clear and unequivocal. It requires that the assured, or a permanent employe of assured, or a person whose sole duty it is to attend the vehicle be *actually* in or upon the automobile when the loss occurs.

“(4) 3. It is claimed that a strict construction of the language used by the parties in this exception would lead to an absurd and unreasonable result. In support of this contention, plaintiffs cite various hypothetical situations in which an assured or his employe would be compelled to leave the car, either to secure help in an emergency or where he involuntarily would be required to leave the car unattended for some reason or other beyond his control. It is entirely possible under such circumstances that it would work a hardship on the assured if a loss should occur, but the plain fact is that it involves a risk which was assumed by the assured and not by the insurer. The result is no

different from that of any other loss which occurs as a result of some cause not covered by insurance. The mere fact that the assured is compelled to assume a loss which has not been covered by the insurance will not justify courts, by a process of judicial construction, in stretching words beyond their usual meaning to compel an insurer to accept a risk not covered by the policy of insurance. The exception was obviously intended to cover any situation where a loss occurred when the property was not protected by the presence of someone in or upon the car, as required by the language of the exception involved."

* * * * *

"* * * but it is difficult to conceive of a more effective deterrent to a potential thief than the presence of some one *in or upon* an automobile. It is extremely unlikely that an attempt would be made to steal from an automobile under these circumstances, and that is no doubt the very thing the insurer had in mind in requiring actual presence in or upon the automobile."

* * * * *

"The language used in the exception involved here is clear and unequivocal. It provides an exception to the general coverage provisions of the policy. The parties were free to contract as they saw fit, and it is not for us to rewrite their contract by construing language to mean something which it obviously does not mean. The plain fact is that this insurance policy covered certain types of losses and excluded others. The loss here involved was one assumed by the owner of the property and not by the insurer." (50 NW 2d at pages 632-636).



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IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

CENTENNIAL INSURANCE COMPANY, a Corporation,
Appellant,

vs.

DAVE SCHNEIDER, Doing Business as DAVE SCHNEIDER
WHOLESALE JEWELRY,
Appellee.

APPELLEE'S BRIEF.

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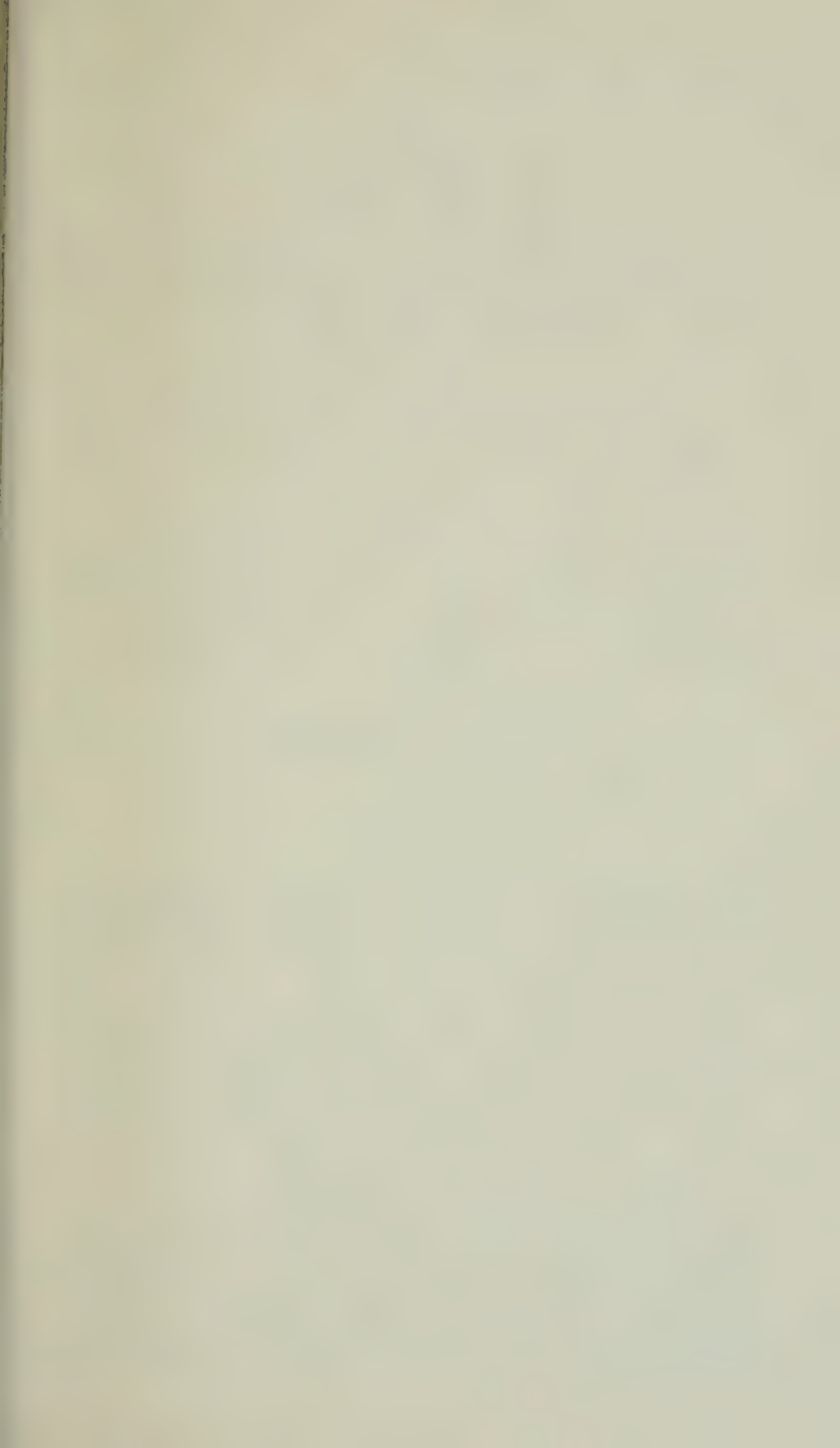
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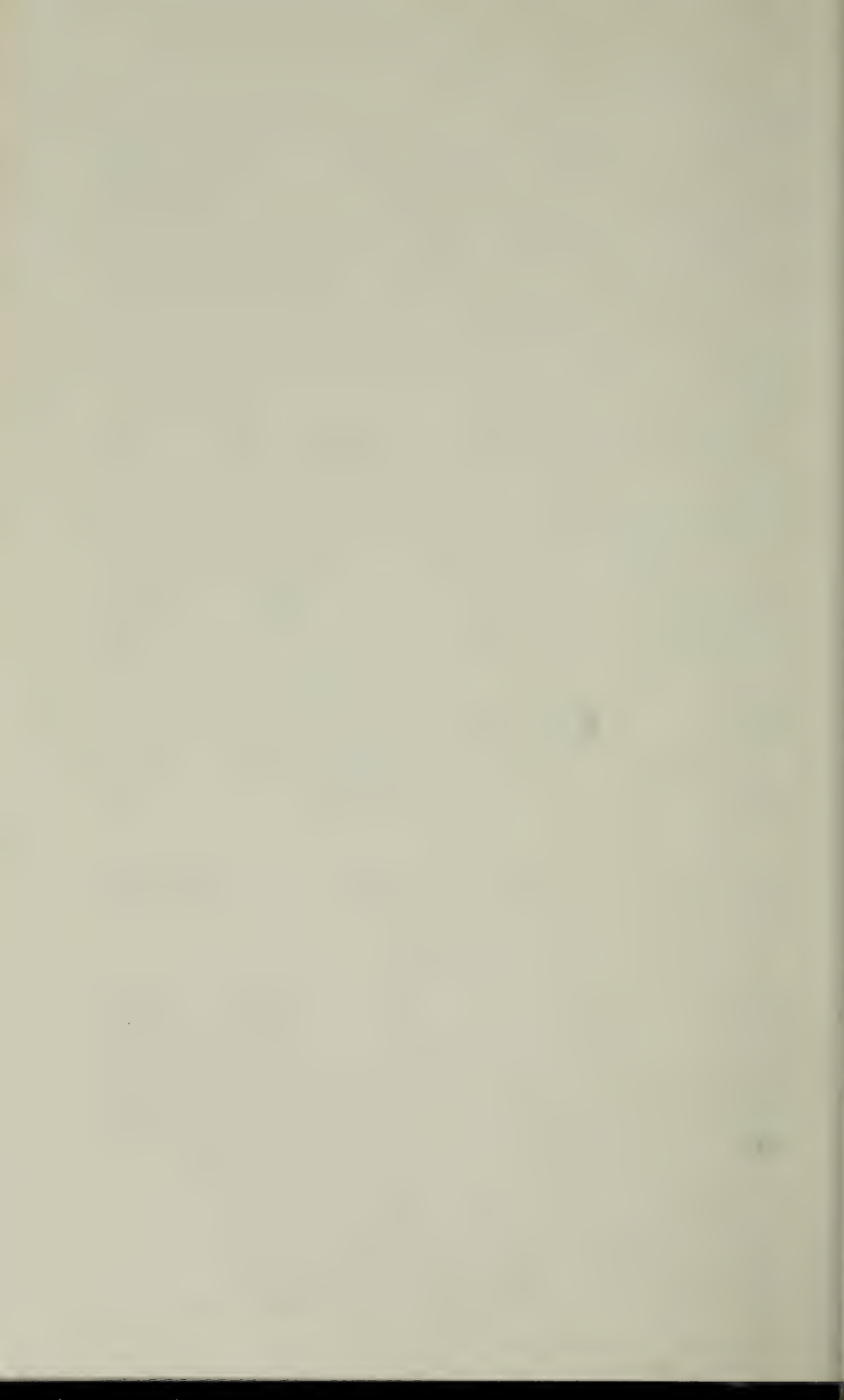
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WHOLESALE JEWELRY,
Appellee.

APPELLEE'S BRIEF.

Jurisdiction.

The basis for the jurisdiction of the District Court of the United States for the Southern District of California, Central Division, to try this case and enter judgment therein, and for the above entitled United States Court of Appeals to review that judgment, is correctly stated in Appellant's Opening Brief, and we adopt that statement as the basis for that jurisdiction.

Statement of the Case.

The defendant's (appellant's) statement of the case is not sufficiently full in order that we may argue points which we feel are important, and, therefore, we desire to augment defendant's statement, and in doing so if we re-iterate portions of their statement, it is for the purpose

of conveniently and coherently presenting our statement of the case, without requiring the court to refer back to defendant's statement.

A. Undisputed Facts.

The defendant for a valuable consideration issued to the plaintiff a policy of insurance whereby the defendant insured the plaintiff "against all risks of loss of or damage to" jewelry and other property "arising from any cause whatsoever," occurring within one year from August 15, 1954, subject to exceptions and conditions contained therein [Pltf. Ex. 1—Insurance Policy]. On December 3, 1954, the plaintiff suffered a loss of jewelry and other property worth \$25,360.01, and also the loss of sample cases and trays worth \$914.50, or a total loss of \$26,274.51 [T. R. pp. 43-45; Pltf. Ex. 2, Proof of Loss]. Because the loss occurred from an automobile, the maximum liability of the defendant under the policy could only be \$15,914.50 [Pltf. Ex. 1]. The loss has not been paid.

B. Statements, Contentions and Admissions of Defendant in Its Brief and Answer as Constituting a Basis That Jewelry and Cases Were in the Automobile at the Time of Loss.

"Two cases of jewelry as large and cumbersome as plaintiff's cases do not simply evaporate into thin air. Something must have happened to them and the most logical conclusion is indeed that which the trial court reached, namely, that someone stole them." (Appellant's Op. Br. p. 13.)

"It is our position that, under clause 5 (I), defendant merely had the burden of proving that the loss occurred while the jewelry was in the automobile." (Appellant's Op. Br. p. 16.)

“That the alleged loss occurred, if it occurred at all, while the said property was in or upon an automobile . . .” [T. R. p. 15, Third Defense in the Answer.]

C. Manner of Carrying Jewelry and Operation of Automobile.

When traveling plaintiff put the cases in rear trunk compartment of his car [T. R. p. 50]. If the lock is disengaged the trunk lid goes up all the way and would block his vision through the rear window, if he was looking [T. R. pp. 60-61]. On the day of the loss plaintiff never saw the back (referring to the lid of the trunk) come up, and the only way he could see it in the rear view mirror if it came up all the way [T. R. pp. 55, 61]. Plaintiff had no trouble with the locking mechanism of the trunk prior to and including December 3rd, the day of the loss [T. R. p. 60]. To plaintiff's knowledge something couldn't just slide out of the trunk compartment as he drove along [T. R. p. 69]. So far as plaintiff knew, no one else had a key to the trunk [T. R. p. 88].

D. Events at Bruce Jewelers.

At Bruce Jewelers plaintiff displayed his merchandise, and while there, put the cases back in the car again, and locked the trunk which locks automatically, and left there about 2:00 P. M. [T. R. pp. 58-59].

E. Events on Trip From Bruce's to Joy Jewelry.

Plaintiff went from Bruce's to Joy Jewelry Company, a distance of about a block and a half, which took him about 15 minutes, and made no stops en route to Joy's [T. R. p. 59], and he didn't know that they were stolen

during that trip [T. R. p. 60]. Plaintiff was in motion the entire time, except for traffic lights, or slowed up, and didn't remember if he stopped [T. R. pp. 61-62]. On this trip plaintiff did not notice the lid go up [T. R. p. 61].

F. Events at Joy's.

Plaintiff testified that he parked his car in front of Joy's, maybe a car space below, and went to the doorway of Joy's but never went completely in [T. R. p. 62], asked for Mr. Stelzer, and was then about 15 feet from the car, and was watching the car, and Stelzer came to the doorway and plaintiff talked to Stelzer there, but did not take his cases out of the car then [T. R. p. 63]. Stelzer and plaintiff got into plaintiff's car, drove around the block and went into a little alleyway at the back of Stelzer's store (Joy's) where Stelzer wanted to show plaintiff a car he had purchased for his wife [T. R. pp. 63-64, 66]. It is a blind alley, wide enough for just about a car [T. R. p. 64]. Plaintiff drove his car immediately in back of Stelzer's Ford car, and thought the cars were bumper to bumper, but could have been a foot away [T. R. p. 66]. Plaintiff got out of his car, locked the two doors, and got into Stelzer's car, and the tail end of plaintiff's car was sitting on the sidewalk [T. R. p. 67]. When plaintiff got into Stelzer's car he was watching his car, having adjusted the rear view mirror of Stelzer's car, so he could see it, and off and on was looking through the rear view mirror, and plaintiff was in Stelzer's car talking to him about 10 to 15 minutes [T. R. pp. 68, 70]. Plaintiff has no way of knowing whether or not the cases were stolen out of his car at that time, and did not check the trunk at that time before he drove away to see whether or not the cases had been taken out [T. R. p. 70].

Stelzer testified that plaintiff never came any further into his place of business than the doorway, and at that time plaintiff's car was in plain sight of Stelzer, and then they went around in plaintiff's car to the back and parked, and got out and looked at the car he purchased for his wife [T. R. p. 109]. As to plaintiff's car when it was parked in the alley, Stelzer said:

"Q. Was the car in your sight all of the time?

A. Yes.

Q. Was there any particular reason that you were observing the car? A. Well, I observed the car because I knew Mr. Schneider was parked really against the law, across the sidewalk. I think he was extending out over the sidewalk and very close to the red zone which starts right at the end of the sidewalk and down." [T. R. p. 110.]

Stelzer also testified that they were there close to five, six or seven minutes [T. R. pp. 110-111] and as follows:

"Q. Were you in such an area that you feel, if anyone had come there, you would have seen them, aside from you and—A. Yes, I think so.

Q. Did you see anybody? A. No, sir.

Q. Did you hear them? A. No, sir.

Q. Nothing of an unusual nature? A. No, sir." [T. R. p. 111.]

G. Events on Trip From Joy's to California Premium Service.

From Joy's plaintiff went to California Premium Service, and there was quite heavy traffic, and traffic was just letting out from aircraft places, and he would say it took almost 45 minutes, which is very unusual, and left Joy's about 3:45 P.M. [T. R. p. 70]. It was just beginning to

rain, the roads were slick, and it is about 4 miles from Joy's to California Premium Service and it was not a continuous drive from Joy's to California Premium, because he was constantly stopping for traffic [T. R. p. 71]. Plaintiff stopped for traffic lights, however, stopped more in the middle of the block than at any other place, and at times stopped from three to five minutes in this congested traffic, because it took him quite a long time to get over there and it really was a short distance [T. R. p. 97]. He was not really watching the rear trunk lid between Joy's and California Premium Service, but watching the traffic up ahead [T. R. pp. 71-72]. Nothing unusual about the trip from Joy's to California Premium Service except they were riding bumper to bumper [T. R. pp. 72-73, 78]. Between Joy's and California Premium Service did not see the trunk compartment go up at any time [T. R. p. 77]. Plaintiff does not know whether the cases were stolen during that trip [T. R. p. 78].

H. Events at California Premium Service.

Plaintiff parked his car in front of the California Premium Service, so that the rear end of his car was about four or five feet away from the entrance [T. R. p. 79], so that he could see it may be from the doorway, or from any part in the store [T. R. p. 80]. Plaintiff got out of his car when he got there, and it was raining at the time, and went to the doorway, but did not take the cases out [T. R. p. 80]. He stayed at the doorway without going in just long enough to ask for Mr. Nigro, and he came up and talked to plaintiff and plaintiff was facing the car the whole time and was watching it [T. R. p. 81]. There was a man and woman in the store with a diamond and Nigro asked him to look at it, and plain-

tiff said he would, and Nigro said that he would look at plaintiff's car or watch his car for him until he looked at the stone [T. R. pp. 81-82]. When he was examining the diamond he was facing the entranceway, looking kind of a little bit half way [T. R. p. 83]. Was not looking at the car at the time he was looking at the stone, but it didn't take very long [T. R. p. 84]. Looked at the stone not over a minute [T. R. p. 85]. Thereafter he went out to the car and opened up the back and the merchandise was gone [T. R. pp. 86-87], meaning that somehow or other, the merchandise had been lost out of his car [T. R. p. 88]. When plaintiff discovered the loss he went into the California Premium store and asked to use the phone [T. R. pp. 88-89], and whether he called the insurance company before the police, he didn't remember but thought he called his office first, and thought someone else called the Sheriff's Department [T. R. p. 89] and Sheriff's Deputies arrived about 20 minutes later [Pltf. Ex. 2—Proof of Loss].

Mr. Nigro, proprietor of the California Premium Company, testified that he remembered the occasion when plaintiff lost the jewelry [T. R. pp. 121-122], and when plaintiff came to his store there were some people in his store looking at a diamond [T. R. p. 122] and after he had a conversation with plaintiff, plaintiff examined the diamond [T. R. p. 123], and Nigro also testified as follows:

“Q. Can you tell the court what you were doing while my client was looking at this diamond? A. Yes, I can.

Q. What were you doing? A. I was looking at his car.

Q. At his car. Can you tell us whether or not, during the time that my client was at your place

of business, anybody went into the back end of his car from the time he left to look at the diamond until he went back to the car? A. Yes I can.

Q. Was there anybody? A. No, there couldn't." [T. R. p. 123.]

I. Plaintiff's Testimony as to Watching His Car.

"Q. Following up this bathroom thought, did you go to the bathroom at any time that day, for any purpose, between the time of leaving your place of business at ten o'clock in the morning up until after you discovered these missing cases somewhere around four or five o'clock in the afternoon? A. Just before I left.

Q. And that is the only time you went near a bathroom? A. Yes.

Q. The rest of the time you were either in your car or, as you say, going in and out of the stores but having the car in view; is that correct? A. Yes, sir." [T. R. p. 71.]

"Q. Do you know whether or not the cases were stolen during the trip from Joy's to the California Premium Service? A. That is the only place it could have been stolen, because I was watching it all the other time." [T. R. p. 72.]

J. Inventory.

Plaintiff immediately gave a copy of the inventory to the police, and while that was not an inventory of the stuff he had, it was an inventory of what the salesman had [T. R. p. 91] and he gave them that inventory for the similarity, because they use the same samples for each line, and when they pick out lines for salesmen, they

pick exactly the same thing right down the line [T. R. pp. 91-92].

Plaintiff testified as follows:

“Q. (By Mr. Hauerken): Did you have an inventory that morning, December 3, 1954, of the merchandise in your possession and in the cases in the trunk of your car, that you state was lost on December 3rd? A. I have an inventory all of the time of everything in the place, including what I have in my car and what I have in the salesman’s car.” [T. R. p. 91.]

“Q. That was the inventory in being on December 3, 1954, of merchandise in your car, which you state was lost that day? A. Well, there actually was a list, but I couldn’t find it in the confusion we had between Pinkerton and Mr. Sully, and quite a few of the others were in and out of that office. It was a question—somebody got it, I don’t know who did. This particular one, to the best of my knowledge, was as close and accurate as I could give at the time.” [T. R. p. 92.]

“Q. There was no inventory in being on December 3, 1954, that you ever produce and submitted to the Centennial Insurance Company; isn’t that correct? A. There was one, but as I said before, I could not find it. However, the way to take a real, true picture of it is to take all the sample lines, which I did, and put them all into stock, and sat down with the girls and the fellows in the office and the shop, and we worked around the clock to get it out for the Police Department and for you.” [T. R. p. 94.]

On March 17, 1955, the following stipulation was entered into with defendant's counsel, as shown on page 5 of Defendant's Exhibit B, being insurance statement under oath on March 17, 1955, and this was one year prior to the trial on March 26-27, 1956:

"Mr. Hauerken: I will enter into this stipulation with you, Mr. Hengel. In the event I see fit to request the books and records, that you and I have a stipulation that I may, if I see fit to employ an accountant to go in and review the books and records and take such photostatic copies as I see fit, and I will make that determination within 30 days after this examination under oath is transcribed and signed.

Mr. Hengel: May we add this: Not only would you make that determination, but you will make such copies of the inspection within that 30 days.

Mr. Hauerken: It may not be humanly or physically possible to do that, however, we will start it and proceed as diligently as possible.

Mr. Hengel: Let's put a stop-gap of 30 days, and if you need more time then we can stipulate to that, possibly, later." [Deft. Ex. B, p. 5—insurance statement under oath of Dave Schneider, taken on March 17, 1955.]

The plaintiff also testified under redirect examination as follows:

"Q. It is simply this: Whether you actually designate whatever list you had in your establishment as an inventory or whatever you call it—names, I claim, are not important—did you have data there from which the amount of your loss and what you lost could be ascertained?

Mr. Hauerken: May I note the same objection, your Honor?

The Court: Yes. It is overruled.

Q. (By Mr. Ely): Did you have it? A. Yes.

Q. And did you show it to the representatives of the company? A. They sent a man over.

Q. Do you remember his name? A. No, sir. It was a gentleman they sent over to check my file.

Q. To check your books? A. Yes." [T. R. p. 105—Redirect Examination.]

The plaintiff under direct examination, gave substantially the same testimony [T. R. p. 45] and also said:

"Q. And was that examination made? A. Yes, sir; it was." [T. R. p. 45.]

The following statement was made by plaintiff in insurance statement under oath, taken on March 17, 1955 [Deft. Ex. B] and read into the record:

"The second inventory referred to is the one attached to my proof of loss made January 20, 1955, which was prepared in connection with said proof of loss and shortly before the filing of said proof of loss with said insurance company, and this second inventory is a correct inventory of said loss that occurred on December 3, 1954, and was prepared by checking my books, records, and merchandise." [T. R. pp. 93-94.]

Summary of the Argument.

1. Federal Rules of Civil Procedure, 28 U. S. C. A., Rule 52(a) provide that findings of fact shall not be set aside unless clearly erroneous. The findings of fact are not erroneous, and therefore the conclusions of law were proper, and the judgment that was made and entered thereon should be affirmed.

2. That plaintiff's *prima facie* case was established when he proved that his loss came under the following provision of the policy: "5. This policy insures against all risks of loss of or damage to the above described property arising from any cause whatsoever . . ."

3. That Clause (I) in the policy (automobile exception), as a whole is an exception, and that the defendant has the burden of proving that it comes within the whole thereof, including that plaintiff was *not* in or upon the automobile at the time the loss occurred. That the defendant also has the burden of proof as to any other exception.

4. That the automobile exception should be strictly construed against the insurer and liberally in favor of the insured, especially since the following portion thereof is ambiguous, to-wit: "Loss or damage to property insured hereunder while in or upon any automobile . . ."

5. The evidence is sufficient to sustain the finding of the court that the plaintiff was in the automobile at the time it was stolen therefrom, regardless of who has the burden of proof, and assuming the plaintiff has that burden, he has sustained the same.

6. Defendant has not sustained the burden of proof as to the following exception, pertinent part of which is: ". . . (M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory." Loss was discovered when plaintiff opened trunk of his car, not on taking inventory.

7. That plaintiff maintained the kind of inventory, books and records required by the policy, and defendant makes no claim that it could not determine the loss therefrom, nor that plaintiff did not suffer the loss.

ARGUMENT.

All emphasis supplied in this brief is ours, except as otherwise specifically designated.

A. Findings of Fact Shall Not Be Set Aside Unless Clearly Erroneous.

Federal Rules of Civil Procedure, 28 U. S. C. A., Rule 52(a), sets forth the rule with reference to setting aside findings of fact by the reviewing court, and we quote the pertinent portion of that rule as follows:

“Findings of fact shall not be set aside unless clearly erroneous, and due regard shall be given to the opportunity of the trial court to judge the credibility of the witnesses.”

This rule has been applied in many cases to sustain judgments of the trial court. In the case of *Martin v. Be-Ge Mfg. Co. of Gilroy* (9th Cir., 1956, Cal.), 232 F. 2d 530, at page 532, the court said:

“This court may not upset a finding of fact of the District Court ‘unless clearly erroneous,’ Fed. Rules Civ. Proc. rule 52, 28 U. S. C. A.; *Graver Tank & Mfg. Co. v. Linde Air Products Co.*, 1950, 339 U. S. 605, 609-610, 70 S. Ct. 854, 94 L. Ed. 1097; *Patterson-Ballagh Corp. v. Moss*, 9 Cir., 1953, 201 F. 2d 403, 407; *Refrigeration Engineering v. York Corp.*, 9 Cir., 168 F. 2d 896, 899, certiorari denied, 1948, 335 U. S. 859, 69 S. Ct. 133, 93 L. Ed. 406; *Maulsby v. Conzevoy*, 9 Cir., 161 F. 2d 165, 167, certiorari denied 1947, 332 U. S. 791, 68 S. Ct. 99, 92 L. Ed. 373; and here there is ample evidence to sustain the finding of non-infringement.”

In the case of *Glens Falls Indemnity Company v. United States* (9th Cir., 1956, Cal.), 229 F. 2d 370, at page 373, the court said:

“In most instances the points urged either involve only questions of fact or are based on assertions of fact contrary to the findings of the trial court. It is not the function of this court to *retry cases on appeal*. Findings of fact by the trial court are *presumptively correct* and will not be set aside unless clearly erroneous. F. R. Civ. P. Rule 52(a) 28 U. S. C. A.”

The following case likewise applies the foregoing rule:

United States v. Fotopulos, et al. (9th Cir., 1950, Cal.), 180 F. 2d 631, 634.

B. Plaintiff's Prima Facie Case.

The plaintiff contends that he has proved his *prima facie* case when he proved the facts as set forth under the foregoing title “Undisputed Facts,” being briefly the existence of the contract of insurance between the parties containing the following all-risk insuring agreement: “5. This policy insures against *all risks of loss* of or damage to the above described property *arising from any cause whatsoever . . .*”; the loss of the property, and the non-payment for that loss.

Under that all-risk insuring agreement we are not called upon to prove the loss occurred because of theft, fire, accident, or any other cause. That particular all-risk insuring agreement is clear and definite, as it most certainly covers *all risks* and *any cause whatsoever*. If defendant wanted to only insure against loss from a particular cause it would have been easy for it to have so

provided, as they prepared the contract, but they chose to insure loss from any cause, thereby making a more attractive policy of insurance to sell to the public, and making it more attractive for the plaintiff to buy.

C. Clause (I), (the Automobile Exception), as a Whole Is an Exception. Plaintiff's Interpretation Erroneous, and Their Argument as to Burden of Proof Also Erroneous.

For easy identification of Clause (I), we will designate it as the *automobile exception*.

The word "except" follows the last word "whatsoever" in the foregoing all-risk insuring agreement, and following the word "except" are 12 exceptions, being (A) to (M), inclusive, including the automobile exception. Defendant's argument revolves principally around the automobile exception, which is as follows:

"(I) Loss or damage to property *insured hereunder* while in or upon any automobile, motorcycle or any other vehicle unless, at the time the loss occurs, there is actually in or upon such vehicle, the Assured or a permanent employee of the Assured, or a person whose sole duty it is to attend the vehicle. *This exclusion* shall not apply to property in the custody of a carrier mentioned in Section 2 hereof, or in the custody of the Post Office Department as first class registered mail."

It seems as though defendant in its brief is assuming the position that the whole of that exclusionary clause is not an exception.

Later in our brief we are going to take up at greater length the question of the rules and law relating to construction and interpretation of an insurance contract be-

tween plaintiff and defendant, but at this point in our brief we will merely make brief mention of some of them in order to point up our argument in opposition to the position they are taking with reference to the automobile question.

The defendant in its brief bottom of page 16 and top of page 17, concedes:

“We recognize that, in a policy of this type, the burden of proving that a loss is excluded rests upon the insurance company.”

But in fact they want to assume *only* the burden as to *part* of the exclusionary clause when they contend:

“Thus, since the policy in this case excluded losses occurring while the jewelry was in an automobile, the burden was on defendant to establish (by its testimony or by that of plaintiff) that the loss occurred while the jewelry was in an automobile. In order to recover despite that fact, it was then up to plaintiff to establish that he was *actually* (emphasis theirs) in or upon the automobile at the time of the loss. It is *only* (emphasis their’s) in such a case that he could bring himself back within the coverage of the policy. The burden was upon him (it could be on no one else) to prove that his loss came within the exception to the already established exclusion.” (Appellant’s Op. Br. pp. 16-17.)

Their argument that they only have the burden of proving that the jewelry was in the automobile at the time of loss, and that we have the burden of proving that plaintiff was actually in or upon the automobile, is contrary to their own concession that the *burden of proving a loss is excluded rests upon them* (Appellant’s Op. Br.,

bottom p. 16, and top p. 17). It also violates the rule that a contract is to be construed as a whole, and especially violates the construction of an exclusionary clause as a whole. In other words they are not reading and interpreting the automobile exception as a whole, but isolating parts of it, and assuming the burden of only one part, and attempting to shift the burden of the other part to the plaintiff, and this is clearly evident when they say that plaintiff has the burden "to prove that his loss came *within the exception* to the already *established exclusion*." They submit the novel innovation that plaintiff has the burden of proving an *exception to an exception*, and we can find no basis for it. There is only one exception when you read the clause together, and the burden of proving that exception and the whole thereof rests on them. Their argument also violates the rule that exceptions in an insurance policy must be strictly construed against the insurer and liberally in favor of the insured. Their argument also violates the plain reading of the contract when you read the exception with the all-risk insuring agreement, as the insuring agreement, in effect, provides protection against *all risks of loss from any cause*, and that includes loss from an automobile, and no matter who proves that the loss was from the automobile, the insurance company still has the burden of proving that plaintiff was not in or upon the automobile at the time—in other words the insurance company has the burden as to the whole of the exception, not part of it, as the insuring clause is an all-risk agreement, except for the exclusion. Despite the plain reading of that all-risk

insuring clause they say to plaintiff you cannot recover because we proved the jewelry was in the car, and unless you can now prove that you were in it also at the time, your policy does not cover your loss.

They wrote the contract, and if they didn't want to insure jewelry in an automobile, they could have so provided by merely having the exception read: "Loss or damage to property insured hereunder while in or upon any automobile" and stopped there, but they chose not to make the exception that strict, but made the more attractive exception that they did, and by so doing, they made the policy more attractive for plaintiff to buy.

What the defendant is attempting to do by its method of construction, is to create a "condition precedent" out of the automobile exception clause, but notwithstanding that attempt, it still remains an exclusionary clause, and if they wanted to create a "condition precedent" they should have done so in unequivocal terms. Pertinent to this point is the case of *Ransom v. Penn Mutual Life Ins. Co.* (Cal., 1954), 43 Cal. 2d 420, 425, 274 P. 2d 633, which states as follows:

Page 425 of Cal. Report:

"There is an obvious advantage to the company in obtaining payment of the premium when the application is made, and it would be unconscionable to permit the company, after using language to induce payment of the premium at that time, to escape the obligation which an ordinary applicant would reasonably believe had been undertaken by the insurer. Moreover, defendant drafted the clause and had it

wished to make clear that its satisfaction was a condition precedent to a contract, it could easily have done so by using unequivocal terms. While some of the language tends to support the company's position, it does no more than produce an ambiguity, and the ambiguity must be resolved against defendant. (Civ. Code, §1654; see cases collected in 14 Cal. Jur. 443-446.)”

There can be no doubt but that the whole of the automobile exception, is in fact an exception and an exclusionary clause. First, they use the word “except” right after the all-risk clause and before the beginning of detailed specification of exceptions. *Secondly*, right in the clause itself is the provision: “*This exclusion shall not apply to property in the custody of a carrier . . .*” Thus, the language in the policy itself describes the automobile exception as an *exception* and *exclusion*.

If the automobile exception, as a whole, is not an exception, then the other eleven exceptions are subject to the same qualification. If the automobile exception can be partitioned, and parts thereof isolated, and when so isolated, construed and interpreted separately from the rest of the exception, or from the rest of the contract, and thereafter assign the burden of proof to the parties as to the isolated parts, then in like manner the other 11 exceptions are subject to the same treatment. Would it be reasonable for defendant to claim that the other exceptions should be similarly treated? We feel they have erroneously construed and interpreted Clause (I) and their statement as to the burden of proof relating to this clause is likewise erroneous.

D. Statutory Rules Relating to Construction of Contracts.

Since this is a California contract, the laws of California govern its interpretation and construction, and the following statutes are therefore applicable.

The following are sections from the *Civil Code of California*:

Civil Code, Section 1641:

“The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other.”

Civil Code, Section 1643:

“A contract must receive such an interpretation as will make it lawful, operative, definite, reasonable, and capable of being carried into effect, if it can be done without violating the intention of the parties:

Civil Code, Section 1644:

“The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; unless used by the parties in a technical sense, or unless a special meaning is given to them by usage, in which case the latter must be followed.”

Civil Code, Section 1649:

“If the terms of a promise are in any respect ambiguous or uncertain, it must be interpreted in the sense in which the promisor believed, at the time of making it, that the promisee understood it.”

Civil Code, Section 1654:

“In cases of uncertainty not removed by the preceding rules, the language of a contract should be

interpreted most strongly against the party who caused the uncertainty to exist. The promisor is presumed to be such party; except in a contract between a public officer or body, as such, and a private party, in which it is presumed that all uncertainty was caused by the private party."

E. Ambiguity in Exception (I), Automobile Exception.

"Words and Phrases," Permanent Edition, Volume 3, page 440, is authority for the definition of "ambiguous" as follows:

"The word 'ambiguous' means capable of being understood in more senses than one; obscure in meaning through indefiniteness of expression; having a double meaning; doubtful and uncertain; meaning unascertainable within the four corners of the instrument; open to construction; reasonably susceptible of different constructions; uncertain because susceptible of more than one meaning; and synonyms are 'doubtful,' 'equivocal,' 'indefinite,' 'indeterminate,' 'indistinct,' 'uncertain,' and 'unsettled.'"

In *"Words and Phrases," Permanent Edition, Volume 3, page 437, "ambiguity" is similarly defined.*

The automobile exception is ambiguous. It says "loss or damage to property while in or upon an automobile . . ." It says "loss *to property*"; it does not say "loss *to the owner*." How can "loss to property" mean anything other than "damage to property?" There cannot be theft *to* property. There can be theft *of* property. There could be loss *to* the owner, perhaps, in a technical sense, by a theft. But the exception does not even say that. How could an ordinary layman interpret

“loss or damage to property” to mean “theft from an automobile.”

In “*Words and Phrases*,” *Permanent Edition, Volume 25 page 611*, under sub-title of “Damage synonymous” to the general title of “Loss,” numerous cases are given holding that “loss” and “damage” are synonymous. So when applying the rule of strict construction against the insurer, which rule is hereafter argued at more length, the term in defendants policy “loss to property” should be held to mean “damage to property.” In “*Words and Phrases*,” in said *Volume 25 and page 611*, is found the case of *Littrell v. Allemannia Fire Ins. Co. of Pittsburgh, Pa.* (N. Y., 1928), 226 N. Y. Supp. 243, 244, 222 App. Div. 302, and the court at page 244 of 226 N. Y. Supp. said: “The word ‘loss’ implies that the property is no longer in existence, whereas the word ‘damage’ implies that it still exists although in damaged form.” In other words “loss to property” could only be held to mean complete destruction, under the rule of strict construction against the insurance company.

The automobile exception is also ambiguous because it says “loss” while in an automobile. Nothing could be lost while at the same time being in or upon an automobile.

Because of the ambiguity in this exception, we come to the conclusion that this particular exception can apply *only to damage to property*. Jewelry or any other article which is insured under this policy can suffer damage, either in whole or in part, while in or upon an automobile; but it cannot be lost, in any common sense viewpoint, if it is in or upon an automobile. If they wanted to exclude “theft from” the automobile, they could have easily said

so. They cannot inject something in the automobile exception that is not there, and "theft from" or "lost from" an automobile is not in there, and therefore they cannot claim that there is an exception as to property "stolen from" or "lost from" the automobile.

The use of the preposition "to" in the automobile exception, speaking of "loss or damage *to* property while in or upon an automobile" excludes, by every reasonable rule of construction and common sense, the intent that theft *of* the property could be included within such exclusion.

F. Words of a Contract Are to Be Understood in Their Ordinary and Popular Sense.

In the case of *New York Life Ins. Co. v. Hiatt* (9th Cir., 1944, Cal.), 140 F. 2d 752, this court at page 753 said:

"Speaking of an ambiguity imported into a policy by a similarly stamped provision relating to incontestability, a California appellate court observed in a recent decision that the applicable measure of understanding is not that of one engaged in the insurance business or trained in the law. 'The proper test,' said the court, 'is what the drafter of the instrument might reasonably anticipate to be the effect upon an untrained mind for it is to that class that the instrument is designed to be offered.'"

The *Civil Code of California*, Section 1644, which we have heretofore quoted, provides in part as follows: "*The words of a contract are to be understood in their ordinary and popular sense, rather than according to their strict legal meaning; . . .*" This rule is applicable to insur-

ance contracts. In the case of *Hyer v. Inter-Insurance Exchange, etc.* (Cal., 1926), 77 Cal. App. 343, 347, 246 Pac. 1055, the Court at page 347 of the California Report said: "The terms used in an insurance policy should be given their plain, ordinary, and popular meaning." And in the case of *Wilmarth v. Pacific Mutual Life Ins. Co.* (Cal., 1914), 168 Cal. 536, 546, 143 Pac. 780; Ann. Case 1915B, 1120, the Court at page 546 of the California Report said: "Whatever the terms 'passenger elevator' and 'freight elevator' may mean technically to those engaged in the manufacture of lifts, these expressions in a policy of insurance are to be construed in their ordinary and popular sense."

G. Exceptions in an Insurance Policy Must Be Strictly Construed Against the Insurer and Liberally in Favor of the Insured.

Exceptions in insurance policies are strictly construed against the insurer and liberally in favor of the insured, and this rule is definitely announced in the case of *Pacific Heating and Ventilating Co. v. Williamsburg City Fire Insur. Co., etc.* (Cal., 1910), 158 Cal. 367, 369-370, 111 Pac. 4, and we quote therefrom as follows:

Pages 369-370 of Cal. Report:

"A policy of insurance is but a contract, and like all other contracts it must be construed according to the language and terms used therein in order to arrive at its true sense and meaning. Courts will not undertake to relieve parties from the express and plain stipulations into which they have entered. But while this is true, it is also a rule well established by the courts, that provisos and exceptions contained in a policy of insurance must be strictly construed against the insurer and liberally in favor

of the insured. This rule is based upon the fact that the contract of insurance is drawn by the insurer, and in it are usually placed many exceptions, conditions and forfeitures deliberately and purposely by the insurer so as to avoid liability, and the ordinary person in paying a premium and accepting a policy does not read, or, if he does read, he cannot understand the many conditions, exemptions and exceptions contained therein. In fact such provisions, exceptions and conditions in many cases, on account of their ambiguity, have been construed differently by the most eminent lawyers and the highest courts of the land. Therefore the courts endeavor to carry out the contracts as made by the parties and, at the same time, prevent if possible the exceptions and conditions from wholly devouring the policy. It is therefore a fundamental rule that the insurer is in duty bound to use such language as to make the conditions, exceptions and provisions of the policy clear to the ordinary mind, and in case it fails to do so, any ambiguity or reasonable doubt must be resolved in favor of the insured and against the insurer."

The case of *Narver v. California State Life Ins. Co.* (Cal., 1930), 211 Cal. 176, 180-181, 294 Pac. 393, 71 A. L. R. 1374, likewise states the rule as follows:

Pages 180-181 of Cal. Report:

"It is a well-recognized rule of law that of any uncertainties or ambiguities appear in an insurance policy which may be solved by either one of two reasonable constructions, the one which is most favorable to the insured and which will give life, force and effect to the policy should be adopted. The insurance company having prepared the policy and all documents used in connection with its issuance,

should not be heard to put such a construction upon an ambiguity, caused by it, as will defeat the policy and take from the beneficiary the very purpose and object of the insurance, if a reasonable construction upholding the insurance can be had that does no violence to the language used and the clear intention of the parties. (*Pacific Heating & Ventilating Co. v. Williamsburg etc. Co.*, 158 Cal. 367 (111 Pac. 4); *Welsh v. British American Assur. Co.*, 148 Cal. 223 (113 Am. St. Rep. 223, 7 Ann. Cas. 396, 82 Pac. 964); *Witherow v. United American Ins. Co.*, 101 Cal. App. 334 (281 Pac. 668).) With this rule in mind, we will proceed to a consideration of the contract of insurance involved in this appeal.’ ”

You will notice that the case of *Pacific Heating & Ventilating Co. v. Williamsburg City Fire Insur. Co., etc.*, *supra*, is cited as authority for the foregoing rule.

In the case of *Pistolesi v. Massachusetts Mut. Life Ins. Co.* (D. C. N. D., Cal., S. D., 1945), 64 Fed. Supp. 427, the court at page 430 said: “The California law being controlling here, I find the decisions of the Supreme Court of that State, without exception, holding to this liberal rule.” And at page 430 of the *Pistolesi* case, *supra*, quotes verbatim the rule that we have heretofore quoted from the case of *Narver v. California State Life Ins. Co.*, *supra*.

To like effect is the recent case of *Ritchie v. Anchor Casualty Co.* (Cal., Aug. 1955), 135 Cal. App. 2d 245, 258, 286 P. 2d 1000, which states:

Page 258 of Cal. Report:

“If the insurer would create an exception to the general import of the principal coverage clauses, the burden rests upon it to phrase that exception in clear

and unmistakable language. (Pendell v. Westland Life Ins. Co., *supra*, at p. 770.) If this is not done any ambiguity or uncertainty is resolved in favor of the policyholder. Indeed an exception must be couched in terms which are clear to the ordinary mind (Pendell v. Westland Life Ins. Co., *supra*, at p. 770) or any doubts as to meaning will be resolved against the insurer."

If the proviso of an insurance contract is susceptible to two constructions, it is to be construed liberally in favor of the insured and strictly as against the insurer, and we quote from the case of *Mah See v. North American Acc. Ins. Co.* (Cal., 1923), 190 Cal. 421, 424-425, 213 Pac. 42, 26 A. L. R. 123, as follows:

Pages 424-425 of Cal. Report:

"But if it be conceded that the language of the proviso is susceptible to the construction contended for by the defendant, it must also be conceded that it is likewise susceptible to the construction here adopted, and we are thus confronted by an uncertainty or ambiguity, which it is our duty to construe liberally in favor of the insured and strictly as against the insurer. This for two reasons: (1) Because it is found in a policy of insurance (Civ. Code, sec. 1654; *Maryland Casualty Co. v. Industrial Acc. Com.*, 178 Cal. 491, 494 (173 Pac. 993); *Wells Fargo & Co. v. Pacific Ins. Co.*, 44 Cal. 397); and (2) because the language in question is found in an exception, attached to the policy, which purports to limit the risk assumed by the insurer in the general provisions thereof. (*Berliner v. Travelers' Ins. Co.*, 121 Cal. 458 (66 Am. St. Rep. 49, 41 L. R. A. 467, 53 Pac. 918).)"

To like effect as the *Mah See v. North American Acc. Ins. Co.*, *supra*, the case of *Bayley v. Employers' Liability Assurance Corp.* (Cal., 1899), 125 Cal. 345, 352, 58 Pac. 7, states:

Page 352 of Cal. Report:

“‘Where the language of a policy may be understood in more senses than one, it is to be construed most strongly against the insurer, because he frames it and is supposed to make it as potent as possible in his own favor; but, where there is no imperfection or ambiguity in the language, it must be construed like any other contract, according to the intention of the parties.’ (Rankin v. Amazon Ins. Co., 89 Cal. 203; 23 Am. St. Rep. 460.) ‘It is a general rule that when a stipulation or exception to a policy of insurance emanating from the insurer is capable of two meanings, the one is to be adopted which is the most favorable to the insured; and when underwriters have left design doubtful by using obscure language, the construction to be adopted is the one most unfavorable to them.’ (Merrick v. Germania Ins. Co., 54 Pa. St. 277.)”

Now, then, if the automobile exception in the instant case is subject to two interpretations, the one placed upon it by the defendant that all they have to do is show that the jewelry was in the automobile at the time it was lost in order to avoid liability, unless the plaintiff can bring himself back under the policy by sustaining the burden of proof that he was in or upon the automobile at the time; or the other interpretation of the plaintiff that the phrase “loss or damage to property insured hereunder while in or upon any automobile . . .” means only

damage to property, and that defendant has the burden of proof as to that, then the construction favoring the plaintiff should be applied, as was done in *Mah See v. North American Acc. Ins. Co.*, *supra*, especially since the automobile exception is ambiguous.

The rules laid down in the foregoing cases of *Pacific Heating & Ventilating Co. v. Williamsburg City Fire Ins. Co.*, *supra*, and *Mah See v. North American Acc. Ins. Co.*, *supra*, were reiterated and applied in the recent case of *Arenson v. National Automobile and Casualty Ins. Co.* (Cal., Aug. 1955), 45 Cal. 2d 81, 83, 286 P. 2d 816, as follows:

Page 83 of Cal. Report:

“It is also the rule that exceptions and exclusions are construed strictly against the insurer and liberally in favor of the insured. (*Mah See v. North American Acc. Ins. Co.*, 190 Cal. 421, 424-425 (213 P. 42, 26 A. L. R. 123); *Pacific Heating & Ventilating Co. v. Williamsburg City Fire Ins. Co.*, 158 Cal. 367, 369-370 (111 P. 4).)”

In the case of *Kautz v. Zurich General Acc. & Liab. Ins. Co.* (Cal., 1931), 212 Cal. 576, 300 Pac. 34, at pages 580-581 of that case in the *California Report*, the court reaffirms the rule laid down in, and at considerable length quotes from, the foregoing case of *Pacific Heating & Ventilating Co. v. Williamsburg City Fire Insur. Co.*, *supra*.

In the very recent case of *Ensign v. Pacific Mut. Life Ins. Co.*, 47 A. C. A. 887, 891, decided in February, 1957 (the bound volume has not yet been printed), the court

restated and applied general rules governing the construction of ambiguous clauses in insurance contracts, when it said:

Page 891:

“As recently stated by this court, the following general rules govern the construction of ambiguous clauses in insurance contracts: ‘It is elementary in insurance law that any ambiguity or uncertainty in an insurance policy is to be resolved against the insurer. (Citations.) If semantically permissible, the contract will be given such construction as will fairly achieve its object of securing indemnity to the insured for the losses to which the insurance relates. (Citations.) If the insurer uses language which is uncertain any reasonable doubt will be resolved against it; if the doubt relates to extent or fact of coverage, whether as to peril insured against (citations), the amount of liability (citations) or the person or persons protected (citations), the language will be understood in its most inclusive sense, for the benefit of the insured.’ (Continental Cas. Co. v. Phoenix Const. Co. (1956), 46 Cal. 2d 423, 437-438 (296 P. 2d 801).)”

The foregoing rules of construction and interpretation are also supported by the following cases:

Olson v. Standard Marine Ins. Co. (Cal., 1952),
109 Cal. App. 2d 130, 135-136, 240 P. 2d 379;

Haerens v. Commercial Casualty Ins. Co. (Cal.,
1955), 130 Cal. App. 2d Supp. 892, 894, 279 P.
2d 211.

H. The Whole of a Contract Is to Be Taken Together.

The *Civil Code of California*, Section 1641, which we have heretofore quoted, provides:

“The whole of a contract is to be taken together, so as to give effect to every part, if reasonably practicable, each clause helping to interpret the other.”

This rule has been applied in the Federal Court, and more especially by this court in the foregoing case of *New York Life Ins. Co. v. Hiatt* (9th Cir., 1944, Cal.), 140 F. 2d 752, *supra*, and at pages 752-753 said:

“The rules applied in the construction of insurance contracts are well understood. Like any contract, the policy is to be read as a whole, and if possible the several parts should be reconciled and given effect. 14 Cal. Jr. 440, section 22. Because contracts of insurance are not the result of negotiation and are generally drawn by the insurer, any uncertainties or ambiguities therein are resolved most strongly in favor of the insured. *Blackburn v. Home Life Ins. Co.*, 19 Cal. 2d 226, 120 P. 2d 31; *Glickman v. New York Life Ins. Co.*, 16 Cal. 2d 626, 107 P. 2d 252, 131 A. L. R. 1292.”

In the foregoing case of *Mah See v. North American Acc. Ins. Co.* (Cal., 1923), 190 Cal. 421, 213 Pac. 42, 26 A. L. R. 123, *supra*, at page 424 of the *California Report*, the court applied to an insurance policy the rule set forth in *Civil Code of California*, Section 1641, *supra*, and the court quoted thereat the whole of said section.

Under the foregoing rule the whole of the insurance contract must be read together. In other words, they cannot isolate a part of the automobile exception, as they

attempt to do by saying all they have to prove is that the jewelry was in the automobile at the time of loss; and then isolate another part of that same exception, and say that we have to prove that plaintiff was in the automobile at the time. The automobile exception is to be taken as a whole, and since the automobile exception is in part ambiguous, and being ambiguous should be construed favorably to the plaintiff to mean "damage to the property" while in or upon an automobile while the plaintiff is in and upon the same, therefore, they have the burden of proving the whole of the exception including that plaintiff was in or upon the automobile at the time. Also, under that rule that the whole of the automobile exception is to be taken together, the whole of that exception is to be construed as an exception, and such being the case the defendant has the burden as to the whole thereof.

I. The Automobile Exception in the Ruvelson Case, Upon Which Defendant Relies Is Materially Different Than the One in the Instant Case.

On the question of ambiguity, at this point we want to discuss the case of *Ruvelson, Inc. v. Saint Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50 N. W. 2d 629, upon which the defendants rely so much, so much so that they have made it the subject of the Appendix to their brief. While they do not argue the question of ambiguity with this case in mind, we feel it important to differentiate between the automobile exception in that case and the one in the instant case.

At page 14 of *Appellant's Opening Brief*, they say:

"The leading case on the subject is *Ruvelson v. St. Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50

N. W. 2d 629, decided in 1951 by the Supreme Court of Minnesota. The policy involved in that case insured the property of a wholesale jeweler against loss or damage 'arising from any cause whatsoever.' *It also contained an exclusion clause which, except for one immaterial difference in spelling, was word for word the same as clause 5(1)."*

It is not word for word the same and the difference is very material, as we will point out. We quote the exception in the *Ruvelson v. St. Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50 N. W. 2d 629, *supra*, from page 630 of the *Northwestern Reporter*, as follows:

"Plaintiffs are engaged in the business of selling jewelry and diamonds to dealers. On October 8, 1949, defendant issued a policy of insurance to plaintiffs under which it insured plaintiffs for a period of one year against 'loss of and/or damage to the above described property' (which included the property here involved) or any part thereof arising from any cause whatsoever except as hereinafter mentioned, viz:

"Thereafter follow 12 separate exceptions, including paragraph (I), which is involved in this appeal. Paragraph (I) reads: '*Loss of or damage to property insured hereunder whilst in or upon any automobile, motorcycle or any other vehicle unless, at the time the loss occurs, there is actually in or upon such vehicle, the assured or a permanent employee of the assured, or a person whose sole duty it is to attend the vehicle; * * **'". (Emphasis supplied by the Court.)

You will notice in the foregoing quoted exception it definitely provided "Loss *of* or damage to property," but in the instant case we have "Loss or damage to property." The material difference is the presence of the word "of"

in one, and the absence of that word in the other. "Loss of property" is readily understandable. Thus, when considering our argument on the question of ambiguity, we claim that the two exceptions are materially different. And may we point out that the insurance company in the *Ruvelson* case, *supra*, easily made that part of the exception clear by the usage of the word *of* in the right place, and the defendant in the instant case could have done likewise, if it wanted to.

J. Burden of Proof.

Applying the rules of construction heretofore discussed, we contend that the automobile exception as a whole is an exception, and that the defendant has the burden of proving that defendant comes within the exception in its entirety, including the provision requiring the plaintiff to be in or upon the automobile, as this is as integral a part of the whole exception as any other part.

Particularly apropos is the case of *Bebbington v. California Western States Life Ins. Co.* (Cal., 1947), 30 Cal. 2d 157, 159, 162, 180 P. 2d 673, and we quote therefrom as follows:

Page 159 of Cal. Report:

"One issue is determinative of the appeal. Attached to the policy was a rider providing that in the event of the death of the insured as a result of airplane travel other than as a fare-paying passenger in licensed aircraft flying a regular scheduled passenger flight, the liability of defendant should be limited to the reserve of the policy. Defendant, by answer, asserted that the proofs of death submitted by plaintiff showed that the assured died in an airplane accident while flying a United States Army

plane, thus making operative in defendant's favor the limitation of liability contained in the exclusion clause of the rider.

"The burden of proof was on defendant to establish this defense and show the circumstances which brought the death within the exclusion clause. (Mah See v. North American Acc. Ins. Co., 190 Cal. 421, 425 (213 P. 42, 26 A. L. R. 123); Rossini v. Saint Paul Fire etc. Co., 182 Cal. 415 (188 P. 564); Postler v. Travelers Ins. Co., 173 Cal. 1 (158 P. 1022); Witherow v. United Am. Ins. Co., 101 Cal. App. 334, 336 (281 P. 668); Mattson v. Maryland Casualty Co., 100 Cal. App. 96, 98 (279 P. 1045).) Failure of proof on this issue requires affirmance of the judgment for plaintiff. Defendant was able to show that the deceased was killed in an airplane crash, but failed to show that he was not riding as a passenger in a licensed passenger aircraft at the time."

Page 162 of Cal. Report:

"Moreover, it will be noted that even if the excluded documents had been admitted in evidence, there is no statement in any of them to the effect that the son was not a passenger in a licensed plane at the time of his death. In short, defendant simply failed to prove the essential fact which would make operative the exclusion clause of the rider."

You will notice that in that case the defendant was able to show that deceased was in the airplane crash, but defendant failed to show deceased was *not* riding as a passenger.

In the instant case it was proved that the jewelry was in the automobile when stolen, but the defendant failed to show that plaintiff was *not* in the automobile when the

jewelry was stolen. We believe that defendant concedes that the jewelry was stolen from the automobile.

The automobile exception constitutes the basis for the Third Defense in their answer [T. R. pp. 14-15], which is an affirmative defense, and in that defense, the defendant in substance alleged that the plaintiff was not in the automobile at the time, and therefore the issues were drawn on that theory, and thus they also had the burden of proving that affirmative defense.

At page 18 of Appellant's Opening Brief, they cite and quote from the case of *Rossini v. St. Paul Fire, etc. Ins. Co.*, 182 Cal. 415, 188 Pac. 564, as supporting their contention with reference to burden of proof, but you will notice that in the *Bebbington v. Cal. Western Etc. Ins. Co.*, case, *supra*, the court uses the *Rossini* case to support the rule that the burden was on the defendant insurance company. As a matter of fact the *Rossini* case definitely states:

"In other words, the company must plead and prove the exception or breach which it sets up as defeating plaintiff's *prima facie* right of recovery." (182 Cal., p. 420.)

The following cases are to the same effect:

Page 617 of Cal. Report:

"Moreover, after the plaintiff had proved damage within the terms of the policy, the burden rested with the defendant to show that such loss was produced through some excepted cause. 'Where proof is made of a loss apparently within a policy, the burden is on the insurer to prove that the loss occurred from a cause for which it is not liable.'"

Carr v. International Indemnity Company (Cal., 1922), 58 Cal. App. 614, 617, 209 Pac. 83.

Page 137 of Cal. Report:

“These matters were pleaded as affirmative defenses and the burden of proof therefore was upon appellant, both as to the concealments and as to the materiality thereof.”

Olson v. Standard Marine Ins. Co., supra (Cal., 1952), 109 Cal. App. 2d 130, 137, 240 P. 2d 379.

Page 425 of Cal. Report:

“In considering the claimed insufficiency of the evidence to sustain this finding it is to be remembered that the burden rested upon the defendant to prove by a preponderance of the evidence that facts necessary to bring the case within the purview of the exception to the policy.”

Mah See v. North American Acc. Ins. Co., supra, (Cal., 1923), 190 Cal. 421, 425, 213 Pac. 42, 26 A. L. R. 123.

In the case of *Lumbermen's Mut. Casualty Co. v. McIver* (D. C., S. D. Cal., Cen. Div., 1939), 27 Fed. Supp. 702, 703-704, affirmed in 110 F. 2d 323 (1940), the court said:

Page 704 of 27 Fed. Supp.:

“It is apparent therefore that insurer's contention that an unlicensed minor was operating the vehicle in violation of the state law and within the meaning of the exclusionary clause constitutes a special defense.”

Page 704 of 27 Fed. Supp.:

“It is well established both on principle and authority that when the existence of the policy at the time of the loss has been admitted and compliance therewith has been alleged, the burden of proving

affirmative matter constituting a special defense rests upon the insurance carrier. *Aetna Ins. Co. v. Kennedy*, 301 U. S. 389, at page 395, 57 S. Ct. 809, 81 L. Ed. 1177; *Hartford Fire Ins. Co. v. Morris*, 6 Cir., 27 F. 2d 508; *Murdie v. Maryland Casualty Co.*, D. C. Nev., 52 F. 2d 888, appeal dismissed, 9 Cir., 57 F. 2d 1081; *Kimball Ice Co. v. Hartford Fire Ins. Co.*, 4 Cir., 18 F. 2d 563, 52 A. L. R. 799. The burden of proving the special defense in the case at bar accordingly rests on the Lumbermen's Mutual Casualty Company."

Therefore under the rule that the burden of proof as to an exception is on the insurance company, and also under the rule that the burden of proof of a special defense is on them, the defendant in the instant case has the burden of proving that plaintiff was not in or upon the automobile at the time, and defendant has not sustained that burden.

K. Sufficiency of Evidence to Sustain Finding of Court That the Property Was Stolen From the Automobile When Plaintiff Was in the Automobile.

Court's Finding VII, in part states:

"That the plaintiff's jewelry and sample cases and trays were stolen from the trunk of plaintiff's automobile at a time when the plaintiff was in such vehicle." [T. R. p. 27.]

Assume for purposes of argument that the plaintiff does have the burden of proving that he was in the automobile at the time of the theft, we submit that we have sustained that burden.

We believe that by a fair interpretation of defendant's brief, it concedes that the property was in the automobile at the time of theft. Defendant states:

"It is our position, that under clause 5(I) defendant merely had the burden of proving that the loss occurred while the jewelry was in the automobile."
(Appellant's Op. Br. p. 16.)

"Something must have happened to them and the most logical conclusion is indeed that which the trial court reached, namely, that someone stole them."
(Appellant's Op. Br. p. 13.)

If defendant does not concede that, then it has not sustained even the burden that it claims it only has, and thus its whole argument falls.

There is no direct evidence that plaintiff or anyone else saw the property stolen from the trunk, while plaintiff was in the automobile. However the court, as a trier of the facts, has a right to indulge in inferences from the facts proved, in finding that the property was stolen from the trunk at a time when the plaintiff was in the vehicle. Inferences and circumstantial evidence form a sound basis for the finding.

In the case of *United States v. Fotopulos, et al.* (9th Cir., 1950, Cal.), 180 F. 2d 631, pages 634-635, *supra*, this court applied the foregoing rule, and aptly stated it, as follows:

Page 634:

"The Federal Rules of Civil Procedure command us to sustain the findings of a trial judge, unless clearly erroneous. Rule 52, Federal Rules of Civil Procedure. The same norm governs cases arising under this statute. See, *United States v. Chicago*,

R. I. & P. Ry. Co., 10 Cir. 1948, 171 F. 2d 377, 379-380; Wasserman v. Perugini, 2 Cir., 1949, 173 F. 2d 305; Hubsch v. United States, 5 Cir., 1949, 174 F. 2d 7, 8; United States v. Uarte, 9 Cir., 1949, 175 F. 2d 110. This requires us to give due weight not only to conclusions drawn by the trier of facts from contradictory testimony, *but also to inferences made from testimony which does not stand contradicted directly, but the validity of which is impugned by other evidence in the record, or by legitimate inferences from admitted facts.* See Grace Bros. v. Commissioner, 9 Cir., 1949, 173 F. 2d 170; Pacific Portland Cement Company v. Food Machinery and Chemical Corporation, 9 Cir., 1949, 178 F. 2d 541.”

Page 635:

“While he and the corporal testified that the Army truck struck the left rear corner of the deceased’s truck, the contradiction in their testimony and the physical condition of the truck warranted inferences to the contrary.”

Page 635:

“And the trial court, having made them, any attempt on the part of the appellate court to ‘draw an inference of fact constitutes a “usurpation of the province of the trial court.”’ And this ‘notwithstanding the fact that the evidence upon which the inference is founded is undisputed or without conflict.’ Hamilton v. Pacific Electric Ry. Co., 1939, 12 Cal. 2d 598, 602-603, 86 P. 2d 829, 831. And see, Juchert v. California Water Service Co., 1940, 16 Cal. 2d 500, 507-508, 106 P. 2d 886; State of California v. Day, 1946, 76 Cal. App. 2d 536, 549, 173 P. 2d 399; Webster v. Board of Dental Examiners, 1941, 17 Cal. 2d 534, 539-540, 110 P. 2d 992; and

see, *Grace Bros. v. Commissioner*, 9 Cir., 1949, 173 F. 2d 170, 173-174, 177-178; *Western Union Telegraph Co. v. Bromberg*, 9 Cir., 1944, 143 F. 2d 288, 290-291."

The case of *Mah See v. North American Acc. Ins. Co.* (Cal., 1923), *supra*, 190 Cal. 421, 425, 426, 213 Pac. 42, 26 A. L. R. 123, the court announces and applies this rule, as follows:

Page 425 of Cal. Report:

"It is apparent from the evidence that the person who did the shooting was at the time aiming at Fong Wing. From this, either one of two conclusions could be drawn, either that the shooter knew and recognized Fong Wing and intended to shoot him, or that the shooter intended to shoot someone else and mistook Fong Wing for that other person."

Page 426 of Cal. Report:

"This court has frequently held that even though all the facts are admitted or uncontradicted, nevertheless, if it appears that either one of two inferences may fairly and reasonably be deduced from those facts, there still remains in the case a question of fact to be determined by the jury (or by the trial judge where the case is tried without a jury), and that the verdict of the jury or the finding of the trial judge thereon cannot be set aside by this court on the ground that it is not sustained by the evidence (*Anderson v. Los Angeles Transfer Co.*, 170 Cal. 66 (148 Pac. 212)). In so far as the evidence is subject to opposing inferences, it must upon a review thereof be regarded in the light most favorable to the support of the judgment (*Woodard v. Glenwood Lumber Co.*, 171 Cal. 513, 519, 520 (153 Pac.

951); *Hassell v. Bunge*, 167 Cal. 365, 367 (139 Pac. 800)). ‘In reviewing a question of this kind, all the inferences reasonably possible from the evidence favorable to the plaintiff (the prevailing party) must be indulged by this court.’ (*Bandle v. Commercial Bank of Los Angeles*, 178 Cal. 546, 547 (174 Pac. 44, 45).)”

You will notice that even though the evidence is uncontradicted, and two inferences can be fairly drawn from that evidence, the appellate court will not disturb the judgment if the trial court, trying the case without a jury, draws one or the other inference from that evidence. That is exactly the situation in the instant case.

While we contend that the uncontradicted evidence supports only the inference that the plaintiff was in the car at the time of the theft, let us assume for purposes of argument that the same uncontradicted evidence will support either of two inferences—one that the plaintiff was in the car, or the other that he was not in the car, at the time of theft. Still, if the court indulges in one of those inferences, the appellate court will not disturb the finding based on the inference it has drawn.

The premise is not subject to contradiction that plaintiff was either in the car or was not in the car at the time of the theft. Therefore, if it is conceded by the defendant (or proved by the plaintiff or defendant) that the property was in the car at the time of theft, and we have proved by direct uncontradicted evidence that property was *not* stolen from the car when plaintiff was *not* in the car, then it logically follows that only one other fact could possibly remain—that he was in the car at the time of the theft. Thus by direct evidence and logical

deduction we have sustained the burden that he was in the car at the time of the theft.

Because of the foregoing argument, we have gone into the evidence in as much detail in our Statement of the Case, as we did. We contend the evidence sufficiently and adequately proves that the theft *did not* occur while plaintiff was *not in the car*, because at all times when he was not in the car, he or someone else was watching the car. We believe this statement is supported by the evidence. It doesn't make any difference who was watching the car, the important thing is that it proves that *when he was not in the car the property was not stolen*.

At times the plaintiff was not actually in or upon the automobile, but at such times he was so close to it, and his vigilance in watching it so good, that for all practical purposes we can say that he was in or upon the automobile, even though he was not actually touching it with his hand or foot.

In the case of *Sierra Milling, Smelting & Mining Co. v. Hartford Fire Ins. Co.* (Cal., 1888), 76 Cal. 235, 18 Pac. 267, we have a similar situation and since a syllabus of that case briefly set forth the facts and holding pertinent to this question, we quote the same as follows:

Syllabus:

“By a policy of fire insurance on a mill, the insured warranted that during all the time the mill remained idle it would employ a watchman to be in and upon the premises insured night and day. At the time of the fire, the watchman was on the premises connected with the mill, and a short distance from but not actually in the building, and was engaged in watching over the premises, and in a position where he had a better opportunity of seeing the

property insured than if he had been in the mill building. Held, that the warranty had not been broken."

We believe it is a fair statement that when the court decided that case in 1888, the rules on interpretation were not as liberal as they are now. That case is particularly in point because the watchman though not actually in the building, was watching it and had a better opportunity of seeing the property insured. That is our situation here, because at such times as plaintiff was not in or upon the automobile, he was close to it and except for a minute or two when he was examining a diamond, he was always carefully watching it, and even while he was examining the diamond, someone else was watching it for him and the evidence supports the fact that the theft did not occur while he was examining the diamond. As a matter of fact the property received greater protection when he was watching, than if he was merely in the car when he was driving and not able to watch it as carefully.

The defendants rely strongly on the case of *Ruvelson v. St. Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50 N. W. 2d 629, but that case is distinguishable. At page 631 of the *Northwestern Reporter*, the Court quoted from the complaint, as follows:

"He accordingly went to said Crookston Hotel and, having obtained the relief in which he had been in urgent need, returned to his car about two to four minutes later. During the period while he was in said hotel, certain persons or person unknown broke one of the windows in said car, opened the door from the inside thereof, and removed and stole the whole of said jewels and merchandise, property of the plaintiff."

As we read that case, we believe it is fair to say, that the salesman could not see the car from the place where he was having his coffee in the Hotel or using toilet facilities therein, nor was anyone watching it for him.

In that case it was definitely established that the theft *did* occur when he *was not* in the car. In the instant case the evidence supports the conclusion that the theft *did not* occur when the plaintiff *was not* in the car, and the conclusion that the theft *did* occur at a time when he *was* in the car.

L. Mysterious Disappearance.

The defendant's Fourth Defense in its answer is based on clause 5(M) of the insurance policy [Pltf. Ex. 1; T. R. pp. 15-16], which also is an exception, and we quote the pertinent portion thereof as follows:

“* * * (M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory.”

As to this exception, like all other exceptions, the same rules of construction and interpretation apply, and so also does the burden of proof.

Taking the sentence as a whole, it means that on taking inventory the unexplained loss or mysterious disappearance was disclosed. The rules on construction do permit the separation of the words “unexplained loss” or “mysterious disappearance” from “disclosed on taking inventory.” The sentence must be taken as a whole and read together.

In the instant case, the disappearance was not disclosed on taking inventory, but was disclosed when the plaintiff opened the trunk of his automobile.

The construction placed upon this exception by the defendant, would render the whole policy a nullity, unless the plaintiff could affirmatively prove that the loss occurred by theft, robbery, burglary, fire, accident, or some other *known* cause. This is not a fair interpretation, especially when the policy provides:

“5. This policy insures against *all risks* of loss of or damage to the above-described property arising from *any cause* whatsoever, except: * * *” [Pltf. Ex. 1.]

M. Inventory.

The defendant's Fifth Defense in its answer is based on the following provision of the insurance policy [Pltf. Ex. 1; T. R. pp. 16-17], which is:

“8. It is a condition of this insurance that: (A) The assured will maintain a detailed and itemized inventory of his or their property and separate listing of all traveler's stocks, in such manner that the exact amount of loss can be accurately determined therefrom by the Company.”

The defendant testified that he did have such an inventory, but that he could not find it, and that in the confusion following the theft he doesn't know what happened to it.

Under a stipulation entered into between counsel for plaintiff and defendant, after the loss occurred, the defendant had the right to have an accountant examine plaintiff's books and records and make photostatic copies as it saw fit, and the plaintiff testified that such an examination was made. As a matter of fact at the time examination was made, which was after the stipulation was made on March 17, 1956, they had the Proof of

Loss [Pltf. Ex. 2], in their possession, to which was attached a very detailed inventory of the items stolen.

There is not one word from the defendant that the inventory attached to the Proof of Loss is not correct. There is not one word from the defendant that the exact amount of loss could not be accurately determined from plaintiff's books and records that defendant examined. Therefore, defendant should not complain about the manner in which plaintiff kept his books and records. He was not required to keep a particular set of books and records. Whatever name you give it, he maintained what was required, and from it defendant could determine the loss, as therefrom plaintiff made up the detailed inventory attached to the Proof of Loss, and they do not complain about its accuracy.

"Insurance Law and Practice" by *Appleman*, Volume 5, page 99, Section 3024, states:

"For the same reason that inventories are required, the insurer may require the insured carrying on a mercantile business to keep books so that the loss can readily be ascertained."

Appleman, in that section also states that the provision relating to keeping books constitutes a promissory warranty. We contend that the provision for keeping an inventory, coupled with the reason for keeping it—so that loss can be accurately determined—creates a promissory warranty.

Promissory warranties require substantial compliance only. Even if plaintiff had not kept the kind of inventory defendant wanted, that would not be material, since defendant does not claim that plaintiff did not suffer the loss, nor that the inventory attached to the Proof of Loss is

not accurate, nor that the books and records defendant examined did not support that inventory. In this connection the following cases are in point, page 283:

“Provisions requiring the keeping of records and their production upon request for inspection by the insurer are promissory warranties. Substantial compliance with a promissory warranty is sufficient.”

National Union Fire Ins. Co. v. California Cotton Credit Corp. (9th Cir., 1935, Cal.), 76 F. 2d 279, 283.

Page 726 of 139 Atl.:

“There is nothing before us in the case subjudice that tends to show that the keeping of books and accounts by the assured was material or would have been in the least helpful and necessary to accurately determine the loss of the assured, sustained by him as a result of the robbery. *No suggestion was made, on behalf of the appellant, that the assured did not suffer the loss claimed by him.*”

Michler v. New Amsterdam Casualty Co., Inc. (S. Ct., N. J., 1928), 139 Atl. 725, p. 726, aff'd in 141 Atl. 920.

Therefore we contend that plaintiff has complied with this provision, and whether he has or has not, is not material because they do not complain about not being able to ascertain the loss or check on the loss as detailed by the plaintiff. Defendant does not claim plaintiff did not suffer the loss. As a matter of fact the total loss incurred by the plaintiff is greatly in excess of the coverage under the policy. The actual total loss to plaintiff was \$26,274.51, but the insurance coverage was only \$15,914.50 of that loss.

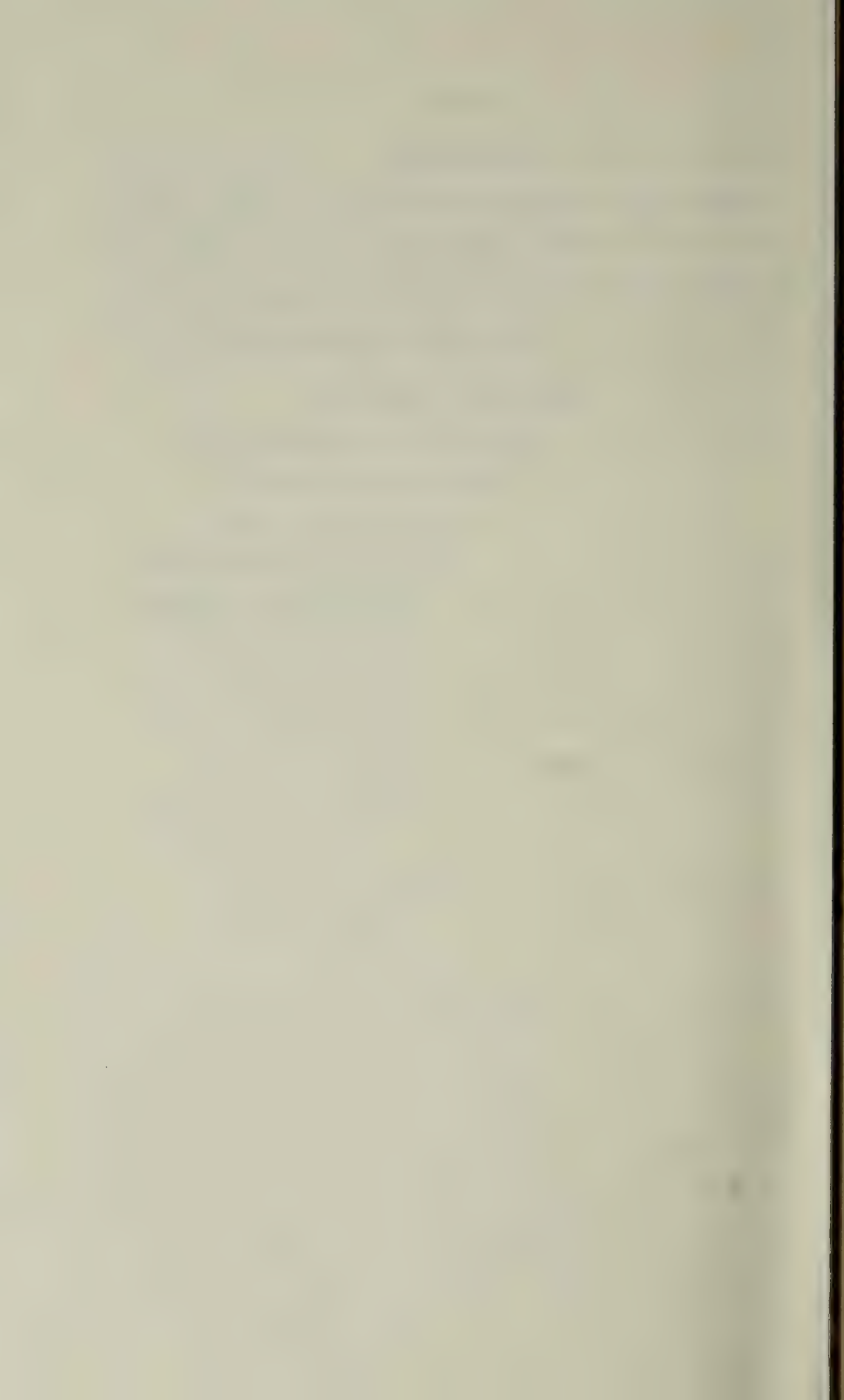
Conclusion.

Appellee respectfully submits that the findings of fact, conclusions of law and judgment are amply supported by the evidence and law, and that there were no errors occurring during the course of this trial which would require its reversal, and prays that the judgment be affirmed.

Respectfully submitted,

BETTS, ELY & LOOMIS, and
SAMUELSON & BUCK,

By WALTER ELY, and
C. RANSOM SAMUELSON,
Attorneys for Appellee.



No. 15,337

IN THE

United States Court of Appeals
For the Ninth Circuit

CENTENNIAL INSURANCE COMPANY, a
Corporation,

Appellant,

vs.

DAVE SCHNEIDER, Doing Business as
Dave Schneider Wholesale Jewelry,
Appellee.

APPELLANT'S REPLY BRIEF.

GEORGE H. HAUERKEN,
HAUERKEN, ST. CLAIR & VIADRO,
635 Russ Building, San Francisco 4, California,
Attorneys for Appellant.

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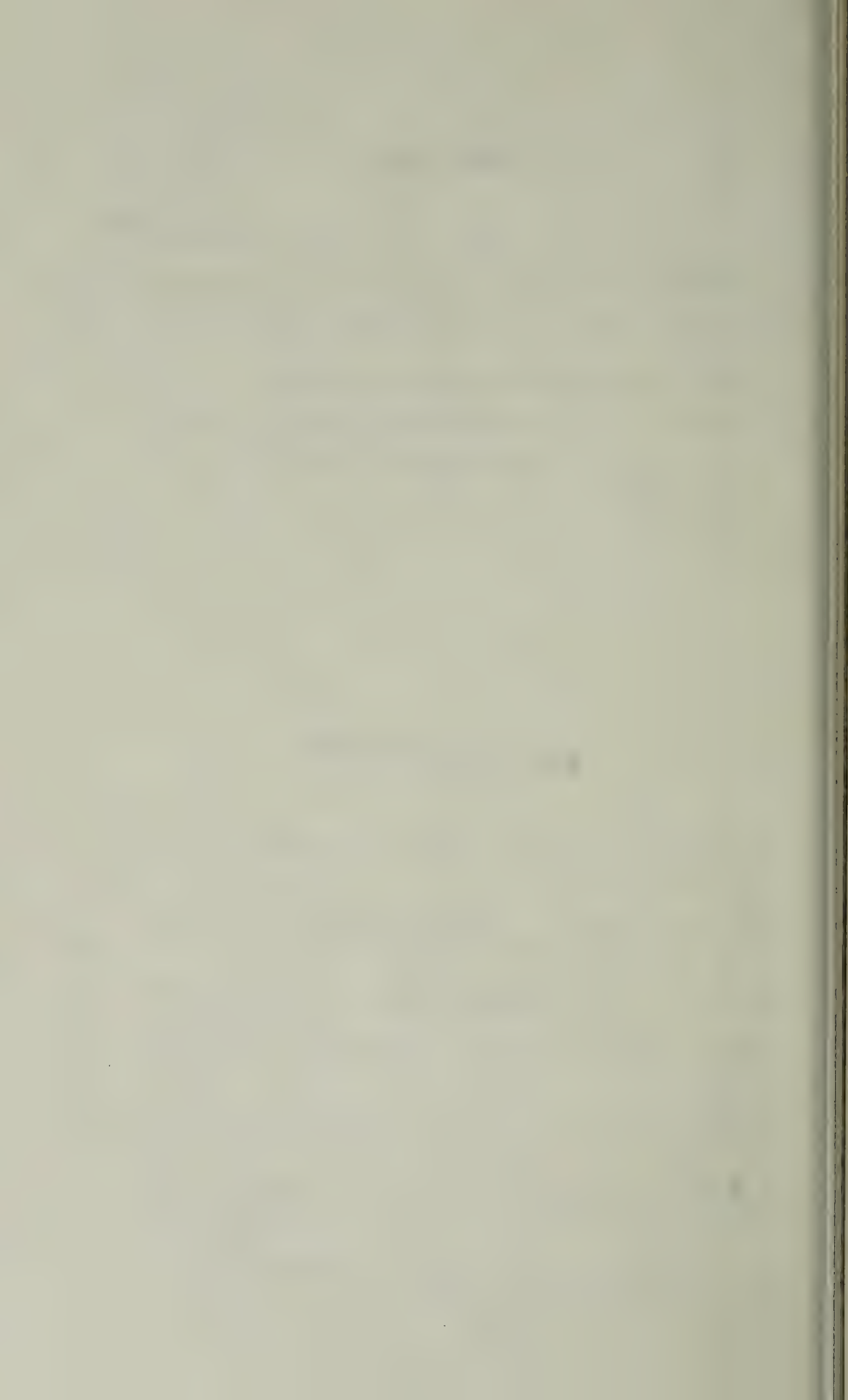


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No. 15,337

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vs.

DAVE SCHNEIDER, Doing Business as
Dave Schneider Wholesale Jewelry,

Appellee.

APPELLANT'S REPLY BRIEF.

We have no quarrel with any of the well settled rules upon which plaintiff relies in his brief. Our quarrel is only with his attempt to make those rules controlling in this case.

**(1) THE ISSUE AS TO THE BURDEN OF PROOF
UNDER THE AUTOMOBILE CLAUSE.**

We agree, for example, that the automobile clause must be read as a whole. It is our position, however, that, read as a whole, it places upon the insured, the

burden of proving that some one was in attendance in or upon the automobile at the time of the loss.

Plaintiff seeks to bolster his position by pointing out that the automobile clause itself refers to itself as an exclusion ("this exclusion shall not apply to property in the custody of a carrier . . ."). The quoted words, however, support our position rather than his. Just as the clause excepts (from the exclusion) a loss which occurred while someone was in attendance in or upon the automobile, it excepts (from the exclusion) a loss which occurred in the custody of a carrier.

It is clear, however, that, if the loss were shown to have occurred in an automobile, the burden would be on the insured and not on the company to prove that the automobile was that of a carrier. Similarly, once an automobile loss is shown to have occurred, the burden must be on the insured, *for it could be on no one else*, to prove that, at the time, someone was in attendance in or upon the automobile.

Plaintiff also contends that the burden of proof should be on defendant for the reason that the automobile exclusion was pleaded by defendant as an affirmative defense.

We may well concede that, generally (although not in every case), a party has the burden of proving that which it is required to plead. This does not mean, however, that a party has the burden of proving every allegation which, for one reason or another (as, for example, for the purpose of clarity), it may find it necessary or advisable to include in a pleading.

For example, the fact that the plaintiff (unnecessarily perhaps) anticipates a defense in his complaint does not shift unto him the burden of proof as to that defense. Similarly, in this case, the burden of proof on the issue of whether plaintiff was in his automobile at the time of the loss was not shifted unto defendant merely because the answer affirmatively alleged that he was not.

If the burden of proof on that issue was originally upon plaintiff (as we believe that it was), it continued to be upon him regardless of what was said on the subject in the pleadings.

In Section J of his brief, plaintiff cites a number of cases in support of his position as to the burden of proof. Each of them is distinguishable as it simply involved the question of the burden of proving an exclusion. None of them involved, as this case does, an exception to an exclusion.

In *Bebbington v. California Western States Life Ins. Co.*, 30 Cal. 2d 157, 180 P. 2d 673, upon which plaintiff primarily relies, the policy excluded coverage "in the event of the death of the insured as a result of airplane travel other than as a fare-paying passenger in licensed aircraft flying a regular scheduled passenger flight". The court held that the insurance company had the burden of proving that the insured was not a passenger in a licensed plane at the time of his death. No other result could have been reached since the policy in that case was not framed in terms of one broad clause excluding air travel coupled with exceptions reinstating the coverage under certain circumstances.

Moreover, it must be noted that there was no hardship in the *Bebbington* case in placing the burden of proof upon the insurance company since the company was in as good a position as the beneficiaries under the policy to prove whether the insured was travelling in a regularly scheduled passenger plane at the time of his death. In this case, however, the insured is the only person who can prove whether he was in or upon the automobile at the time of the loss. Hence, the burden of proof on that issue should be upon him.

Throughout his brief, plaintiff argues that insurance policies must be given a reasonable construction. No construction of the automobile clause is more unreasonable, however, than one which would require the insurance company to prove that the insured was *not* in his automobile at the time of the loss.

**(2) THE ISSUE AS TO THE CLAIMED AMBIGUITY
OF THE AUTOMOBILE CLAUSE.**

Plaintiff contends that the automobile clause is ambiguous because, instead of excluding "loss of or damage to property", it merely excludes "loss or damage to property". Plaintiff accordingly argues that the clause should be held to exclude only *damage* to property in an automobile and should not apply at all to a *loss* of property from an automobile.

That contention is untenable.

We agree with plaintiff that the provisions of an insurance policy should be understood in their or-

dinary and popular sense, that exceptions must be construed strictly against the insurer and liberally in favor of the insured and that, as between two reasonable constructions of a policy, the one which is most favorable to the insured should be adopted.

The very fact that the provisions of an insurance policy must be understood in their ordinary and popular sense makes it clear, however, that, in this case, the construction of the automobile clause advocated by plaintiff must be rejected.

It is of course our position that the automobile clause contains no ambiguity and that it can and must be construed in only one way, namely, so as to exclude the type of loss which occurred in this case. Even if it were ambiguous, however, it is clear that the strained construction urged by plaintiff would *not* be the construction which the ordinary untrained mind would adopt, for the ordinary untrained mind would be most unlikely to notice the absence of the word "of" after the word "loss".

The very cases cited by plaintiff make it clear that it is only a *reasonable* doubt which is resolved in favor of the insured. In this case, the automobile clause is *not* reasonably capable of the strained construction which he urges.

Plaintiff seeks to distinguish *Ruvelson v. St. Paul Fire & Marine Ins. Co.*, 235 Minn. 243, 50 N.W. 2d 629, one of the cases upon which we rely, on the ground that, in that case, the automobile clause did contain the word "of" after the word "loss". The case cannot be distinguished on the basis of that very slight

difference in wording, however, since three of the six cases which we cited in our opening brief (two of which were also cited in the Ruvelson opinion) excluded "loss or damage to" rather than "loss of or damage to" (*Bliss Ring Company v. Globe and Rutgers Fire Ins. Co.*, 7 Ill. App. 2d 523, 129 N.E. 2d 784; *Kinscherf v. St. Paul Fire & Marine Ins. Co.*, 254 N.Y.S. 382; *Princess Ring Co., Inc. v. Home Ins. Co.*, 52 R.I. 481, 161 Atl. 292).

In the Ruvelson case, the court described the purpose of the clause as follows: ". . . it is difficult to conceive of a more effective deterrent to a potential thief than the presence of someone *in or upon* an automobile. It is extremely unlikely that an attempt would be made to steal from an automobile under these circumstances, and that is no doubt the very thing that the insurer had in mind in requiring actual presence in or upon the automobile" (50 N.W. 2d at 635).

With or without the word "of", the only reasonable construction which can be given to the clause is a construction which will achieve the foregoing objective.

(3) THE ISSUE AS TO THE SUFFICIENCY OF THE EVIDENCE.

Plaintiff also contends that, in any event, the finding that the jewelry was stolen while he was in his automobile is supported by the evidence.

Plaintiff concedes that he does not know when or how the theft occurred but nevertheless argues that

the trial court could infer that it must have occurred while he was in the car.

It is our position, however, that the loss *cannot* have happened while plaintiff was in the car and that it must accordingly be held to have happened while he was away from it. The jewelry cases could not have been removed from the trunk of the car without his noticing it. Nor could they have been removed therefrom while he was in the middle of heavy traffic without the theft being noticed and being brought to his attention by one of the many drivers who surrounded him.

Since the loss could not have happened under the circumstances under which plaintiff testified that it must have happened, his testimony to that effect must be rejected as inherently incredible and the findings of the trial judge which purport to rely on that testimony must be held to be altogether unsupported by the evidence.

Of all the cases cited by plaintiff in connection with his argument that the evidence sustains the findings, only *Sierra Milling, Smelting & Mining Co. v. Hartford Fire Ins. Co.*, 76 Cal. 235, 18 Pac. 267, need detain us since the other cases merely deal with broad principles (with which we have no quarrel) as to the trial court's power to draw inferences from the evidence.

All that need be said about the *Sierra Milling* case is that, anything in the syllabus (which plaintiff quotes in his brief) to the contrary notwithstanding, the

watchman *was* upon the insured premises at the time when the fire occurred.

(4) THE ISSUE AS TO THE MYSTERIOUS
DISAPPEARANCE CLAUSE.

As the court will note, plaintiff devotes less than a page to the issue which, to us, is the crucial issue in the case, namely, whether the loss was in any event excluded under the mysterious disappearance clause.

It should first be noted that, although plaintiff argued at length that the automobile clause should be read as a whole, he unhesitatingly asks this court to consider only a portion of the mysterious disappearance clause.

The entire clause provides as follows:

“(M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory. Nor shall this policy cover any shortage in goods claimed to have been forwarded in a package when the package is received by the consignee in apparent good order with seals unbroken, nor for loss of or damage to goods when sent ‘C.O.D.’ with the privilege of inspection by the consignee before delivery.”

Plaintiff, however, quotes only the following part of the clause:

“(M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory.”

Plaintiff then argues that, "taken as a whole", that part of the clause must be construed to cover only an unexplained loss or a mysterious disappearance disclosed upon the taking of an inventory.¹

It is clear, however, that the clause does *not* exclude only losses disclosed on the taking of an inventory. It excludes all kinds of unexplained losses and mysterious disappearances including losses from packages received in apparent good order with seals unbroken as well as losses of goods sent C.O.D. with the privilege of inspection.

Moreover, the same conclusion would have to be reached even if the one sentence which plaintiff is willing to quote were considered alone, for there is only one way in which that sentence can be construed.

The words "unexplained loss" and "mysterious disappearance" *cannot* be limited to a loss (or shortage) disclosed on the taking of an inventory. They must be held to refer to something else, for, otherwise, the words "unexplained loss" would be mere surplusage (and so would the words "mysterious disappearance").

As this court will note, plaintiff makes no attempt to answer any of our contentions as to the meaning of those words. He must accordingly be held to concede

¹It may be noted that, on page 45 of his brief, plaintiff states that "the rules on construction do permit the separation of the words etc.". We assume that plaintiff meant to say that "the rules on construction do *not* permit the separation of the words, etc.". While it is of course our position that the rules of construction not only permit but require the separation of those words, we cannot assume that this typographical slip on plaintiff's part was intentional.

that, if their application cannot be restricted as he seeks to restrict it, the clause exclude the loss which occurred in this case.

As we pointed out in our opening brief, had plaintiff simply testified that he did not know how his jewelry disappeared (without claiming that it disappeared from an automobile), he would have been denied recovery because of the mysterious disappearance exclusion.

The fact that, in addition to testifying that he did not know how the loss occurred, he also testified that it occurred while the jewelry was in an automobile should not place him in a stronger position.

Recovery should be denied on both grounds rather than just on one.

**(5) THE ISSUE AS TO PLAINTIFF'S FAILURE TO MAINTAIN
THE NECESSARY INVENTORY.**

Plaintiff in effect concedes that he did not maintain the required "separate listing of all travelers' stocks". Plaintiff contends, however, that defendant cannot complain of his failure to do so since it does not claim that plaintiff did not suffer a loss or that the inventory which he eventually submitted was inaccurate.

This, in effect, is nothing but a bold attempt by plaintiff to pull himself up by his own boot straps.

Plaintiff was required to maintain a separate listing of travelers' stocks so as to make it possible for defendant to check the accuracy of the claims which he might make under the policy. Having withheld

from defendant the information which would have enabled it to check the accuracy of this particular claim, plaintiff is hardly in a position to contend that, since defendant does not question its accuracy, his failure to submit the necessary information is immaterial.

In fact, our position can be stated in even simpler terms. It is merely that plaintiff made it impossible for defendant to check the loss and that the policy requires defendant to pay only those losses which it had an opportunity to check.

The decision of this court in *National Union Fire Ins. Co. v. California C. Credit Corp.*, 76 F. 2d 279, upon which plaintiff relies is altogether distinguishable. This court held that a policy which required the insured to "keep, or cause to be kept" certain records had been substantially complied with since the necessary records were kept (although not by the insured itself). In this case, however, there was no compliance at all with the requirements of the policy.

(6) CONCLUSION.

As we pointed out in our opening brief, the policy involved in this case covered easily stolen merchandise of high value and was issued to a policyholder who, like all travelling jewelers, was a target for thieves. Hence, it is not surprising that defendant was willing to pay only for losses which plaintiff could explain.

Nor is it surprising that it was willing to pay only for those automobile losses which occurred despite plaintiff's presence in or upon the automobile.

In this case, plaintiff failed to prove that he was in or upon his automobile when the jewelry was stolen and coverage was accordingly excluded by the automobile clause of the policy. Moreover, coverage was also excluded by the unexplained loss and mysterious disappearance clause of the policy.

Finally, recovery should in any event have been denied plaintiff because of his failure to maintain the necessary inventory.

For the foregoing reasons, the judgment should be reversed.

Dated, San Francisco, California,

May 17, 1957.

Respectfully submitted,

GEORGE H. HAUERKEN,

HAUERKEN, ST. CLAIR & VIADRO,

Attorneys for Appellant.

No. 15337

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

CENTENNIAL INSURANCE COMPANY, a corporation,

Appellant,

vs.

DAVE SCHNEIDER, doing business as DAVE SCHNEIDER
WHOLESALE JEWELRY,

Appellee.

PETITION FOR REHEARING.

WALTER ELY,
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PAUL R. [illegible]



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No. 15337
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

CENTENNIAL INSURANCE COMPANY, a corporation,
Appellant,

vs.

DAVE SCHNEIDER, doing business as DAVE SCHNEIDER
WHOLESALE JEWELRY,
Appellee.

PETITION FOR REHEARING.

*To the Honorable Albert Lee Stephens, Chief Judge, and
Homer T. Bone and Richard H. Chambers, Circuit
Judges:*

Now comes the Appellee in the above-entitled action and pursuant to the provisions of Rule 23 of this Honorable Court, petitions as follows:

I.

That a rehearing be granted.

II.

That the Chief Judge convene the active judges of the court, and that the matter be re-heard *en banc*.

The opinion upon which rehearing is sought is dated August 20, 1957.

Grounds for Petition for Rehearing.

Briefly stated, the grounds for this petition for rehearing are as follows:

I.

In its original opinion,* the Court refused to apply Rule 52(a) of the Federal Rules of Civil Procedure.

II.

In its original opinion, the Court refused to apply controlling principles of local law pertaining to burden of proof.

III.

In its original opinion, the Court did not take cognizance of some of the facts, a consideration of which was essential to a just determination.

*Attached hereto as "Appendix A."

ARGUMENT.

The writer of this Petition did not prepare the original briefs in connection with this Appeal, and it is believed that the Court fell into an erroneous decision because of the inadequacy of the time allotted for oral argument and the presentation of issues which the Court has treated simply, but which are complex from the standpoint of the insurance lawyer.

It is believed that the Court's opinion renders a grave injustice to Appellee, and moreover is calamitous in its long-range effect. The insurance contract which the Court has interpreted is not a standard form in the sense that such forms are extant in automobile and fire insurance. Cases in which similar language has been construed are rare, and the Court has only to compare the language of the contract under consideration with that contained in the contracts construed in the other cases in order to see that there is no standardization—that the language utilized by the insurers in these so-called jewelry floater policies is such as to afford the carriers the most protection by the most exceptions and the most ambiguity.

We have set out above, briefly and distinctly as required by Rule 23, the grounds of this Petition, and will discuss such grounds in inverse order:

I.

In Its Original Opinion, the Court Did Not Take Cognizance of Some of the Facts, a Consideration of Which Was Essential to a Just Determination.

We urge the Court to reconsider its decision that clause 5(I) of the insurance contract is "clear and unambiguous" as against Appellee's contention that such clause, with all intendments indulged in favor of him, the assured, does not apply to theft. It is in connection with this importunity that we submit that the Court did not, in its original opinion, consider all of the material facts. On page 3 of its opinion, the Court quotes the pertinent exception, and treats of the claimed ambiguity as if the contention rested upon the language of the exception alone.

The Court neglects to apply the undisputed rule that interpretations of contracts are to be made from a consideration of the contracts as a whole. For the convenience of the Court, we are attaching to this Petition, as "Appendix B," the insuring provisions of the contract, calling attention to these specific facts which the Court overlooked in writing its opinion:

1. The word "theft" is not used in exception 5(I).
2. When the draftsmen who prepared the insurance contract for Appellant intended to write exceptions pertaining to theft, their language was explicit. We direct the Court's attention to exception 5(A), wherein the word "theft" is used, and also to exception 5(K), wherein the words "theft or attempted theft," are used.

The Court has characterized our original argument as "clever," and from the reading of the Court's opinion, indicating that our argument is based upon the language of the exception alone, the characterization might be apt.

But when we see from a close reading of the entire policy of insurance, that when theft was sought to be excluded in exceptions 5(A) and 5(K), language was used which was clear and unmistakable, and then when we, in turn, compare the obscure language of exception 5(I), we must, in good conscience, reject the compliment paid to us by the Court. Our argument is not "clever," and neither is it ingenuous. We submit that the Court, in the interpretation of exception 5(I), failed to take into account the language of the contract as a whole. There was no mention in the opinion of Section 1641 of the California Civil Code, providing "The whole of a contract is to be taken together so as to give effect to every part, if reasonably practicable, *each clause helping to interpret the other.*" (Italics ours.) We submit that we are not being entirely blind when, in view of these omitted considerations from the Court's opinion, we have difficulty in reconciling the Court's interpretation with the established and salutary principle of California law, that:

"If semantically permissible, the contract will be given such construction as will fairly achieve its object of securing indemnity to the insured for the losses to which the insurance relates. If the insurer uses language which is uncertain any reasonable doubt will be resolved against it; if the doubt relates to extent or fact of coverage whether as to peril insured against, the amount of liability, or the person or persons protected, the language will be understood in its most inclusive sense, for the benefit of the insured."

Continental Casualty Co. v. Phoenix Const. Co.
(1956), 46 Cal. 2d 423, 437-438;

Ensign v. Pacific Mutual Life Insurance Co. (Feb., 1957), 47 A. C. A. 887, 891.

II.

In Its Original Opinion, the Court Refused to Apply Controlling Principles of Local Law Pertaining to Burden of Proof.

We are mindful of the careful and commendable thoroughness with which the Court has conducted its investigation into the facts developed by the oral testimony. It is believed, however, that the Court, in ignoring the principle point debated by the litigants at length in their briefs, that is, the question of burden of proof, has constituted of itself an independent fact-finding body. The inferences which this Court draws from the facts are, from Appellee's standpoint, subject to debate,* although we concede that, in the main, the Court's reasoning is logical. But in ignoring the crucial issue, the opinion of this Court, in effect, stamps the learned District Judge as one who is stupid, if not utterly foolish. We submit that this Court's opinion does an injustice to the trial judge and makes him appear idiotic because it does not cast him in a proper light.

This Court concludes that the evidence more clearly points to the fact that Appellee's property was stolen while he was away from his automobile, and, therefore, following analysis of the facts without mention of the lengthy argument devoted in the litigants' briefs to the principle of burden of proof, overturns the finding of fact made by its inferior judge.

*For example, the Court in re-evaluating the evidence states on page 7 of its opinion, "If the traffic was bumper to bumper, (as Appellee testified), so that Appellee could not move speedily, it seems clear that a speedy get-away of the thieves would be impossible." Could this Court not take judicial notice of the fact that cross streets intersect main thoroughfares in the metropolitan Los Angeles area?

The trial court felt itself bound by a principle of local law to which this Court's opinion does not allude. If the trial court had been free to decide the facts independently of any consideration of burden of proof, it very probably would have arrived at the factual conclusion reached by this Court. But the trial judge, as he was obliged to do, applied the well-settled local and almost universal rule that the insurer has the burden of proving the facts which it claims bring into application an exclusion or exception within the terms of an insurance contract.

Referring to "Appendix B," attached hereto, and particularly to Paragraph 5, the coverage afforded is seen to be, "F. This policy insures against all risks of loss of or damage to the above described property arising from any cause whatsoever *except*:" (Italics ours.) Then follows, in fine print, thirteen exceptions, eight sub-exceptions, and fifteen conditions. Among the thirteen exceptions are exceptions 5(A) and 5(K), wherein loss by theft is expressly excluded, and exception 5(I), wherein the term theft is not employed, but which the Court reads into the exception in order to deprive Appellee of benefits for which he had paid an exorbitantly high premium.

In the coverage clause above quoted, we have italicized the word "except." In the body of exception 5(I) which follows the provision as a whole is referred to as "this exclusion."

When, at the time of oral argument, we sought to devote some attention to Rule 52(a), Federal Rules of Civil Procedure, one of your Honors silenced us with the comment that the interpretation of the rule was "Hornbook Law." It is also "Hornbook Law" that, even if we concede that exception 5(I) was applicable to a theft, the burden rested upon the insurer to prove that Appellee's

property was stolen while he was away from the automobile.

Throughout these proceedings, all parties have agreed that the property was stolen at some time during the trip in question. The Appellee could not prove that the property was stolen while he was in the car. The Appellant could not prove that it was stolen while Appellee was away from the car. Therefore, the trial court concluded, as it was bound to do, that since the burden of proof rested upon Appellant, and could not be met, its finding had to be against a fact, the proof of which rested upon Appellant. The holding of the Supreme Court of California in *Bebbington v. California Western States Life Ins. Co.* (1947), 30 Cal. 2d 157, 159, 162, 180 P. 2d 183, demanded judgment for Appellee.

Even if this Court should determine, finally, that our client must suffer his loss without redress, we still urge that the Court, in fairness to the trial judge, grant this petition for rehearing, meet the issue forthrightly, and explain in a supplemental opinion the basis upon which the trial court's judgment was obviously reached. If this Court is to refuse to apply the local law pertaining to an insurance company's burden of proof when an exception is invoked, the opinion should say so. If the Court intended, which it does not say, to reach its factual conclusion with the principle in mind, then potential disputants of the future are entitled to the expression in the opinion of such a guide.

In this connection, the case of *Rossini v. St. Paul Fire & Marine Insurance Co.*, 182 Cal. 415, is interesting and pertinent in making clear that when a fire insurance company sought to invoke an exclusion pertaining to explosion, its contention would have to fail when it was unable to

prove whether the explosion or fire occurred first in point of time.

We realize the heavy burden of work which must rest upon your Honors, but in view of the importance of this decision to the premium-paying public, Appellee sincerely prays that his Petition for Rehearing be granted, and that he have the opportunity to present his position orally before the Court sitting *en banc*.

Respectfully submitted,

BETTS, ELY & LOOMIS, and

SAMUELSON & BUCK,

By WALTER ELY,

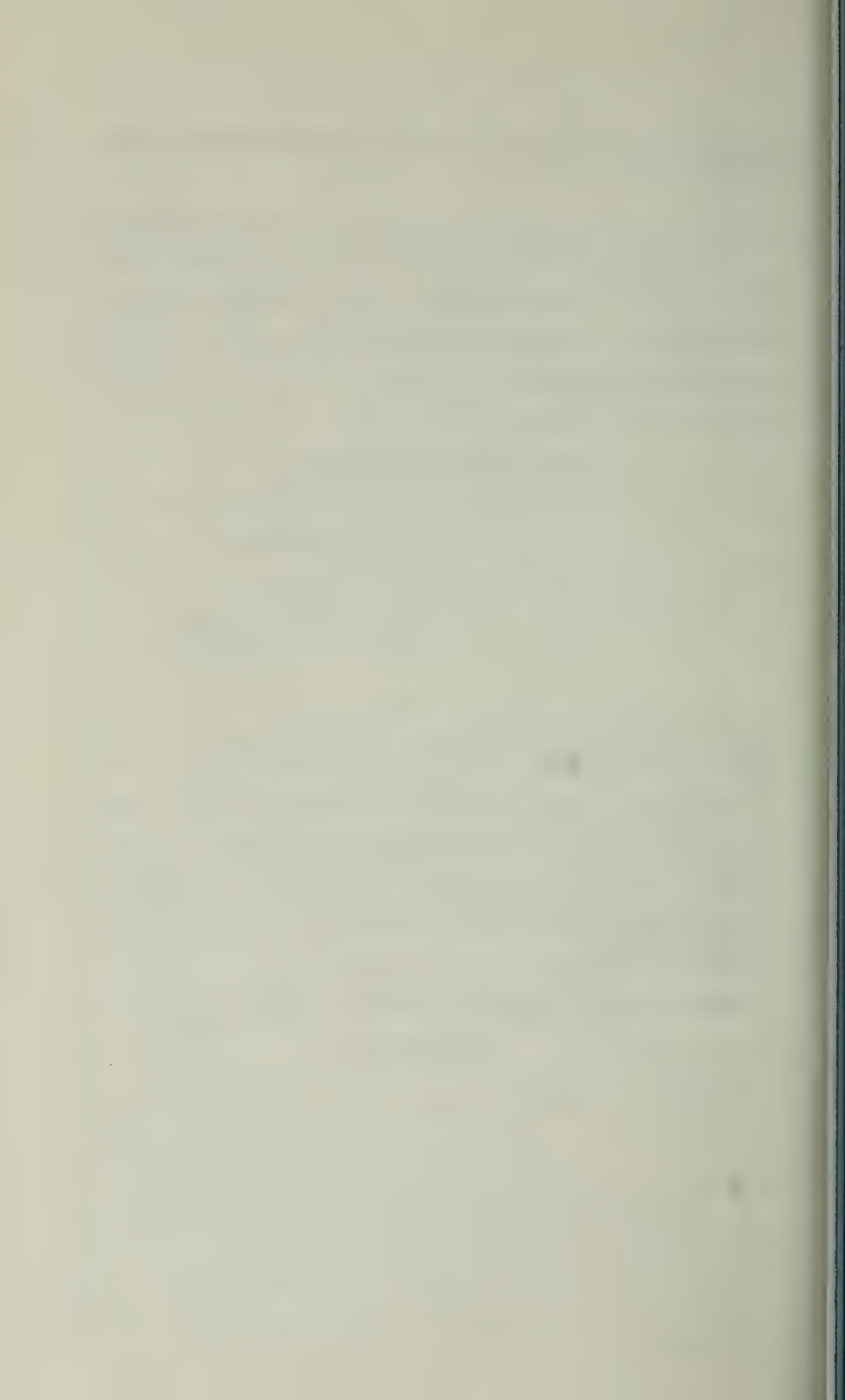
Attorneys for Appellee.

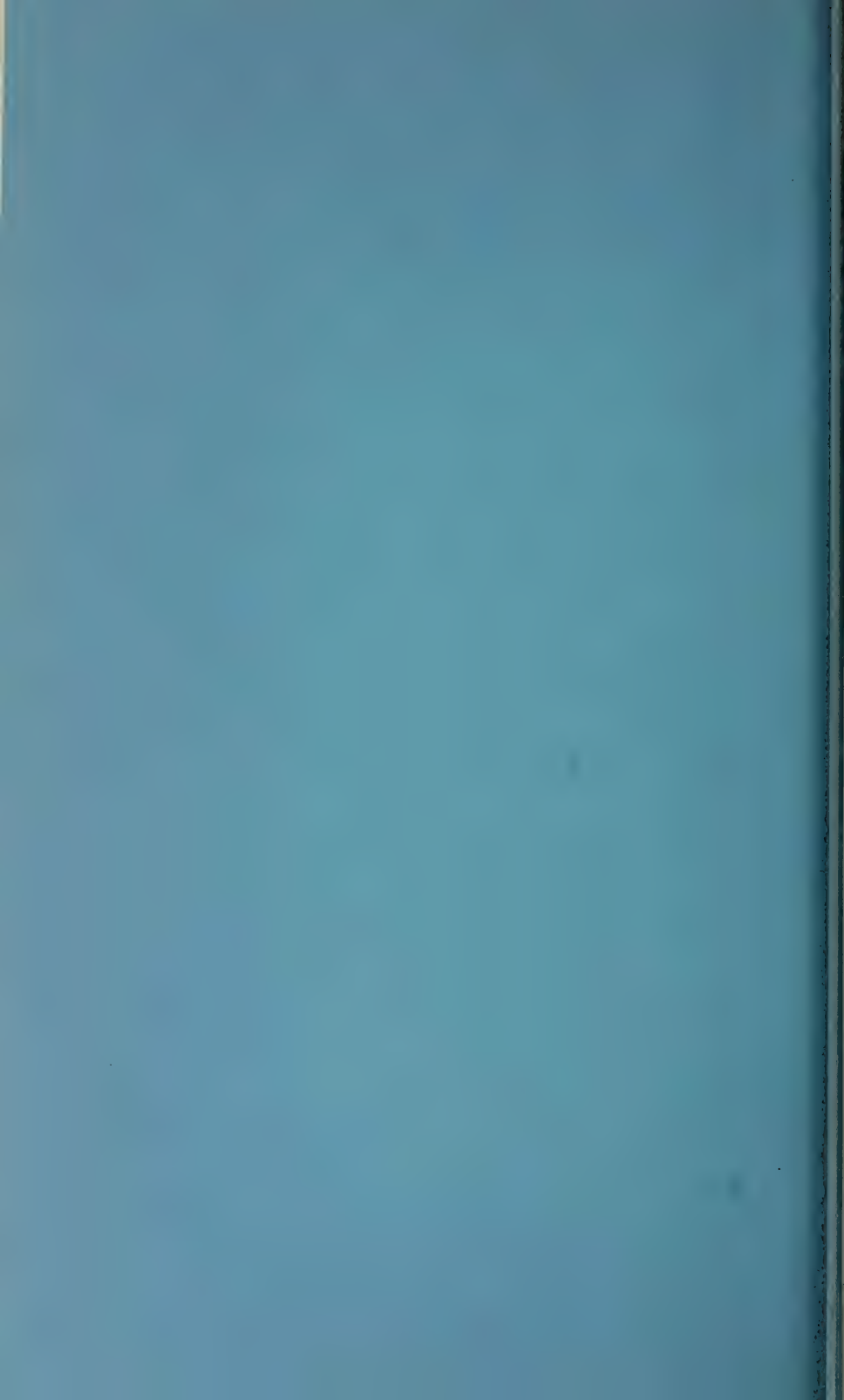
State of California, County of Los Angeles—ss:

Walter Ely, the attorney upon whom the chief responsibility has rested for the representation of Appellee, hereby certifies that, in his judgment, this Petition for Rehearing, prepared by him, is well founded and that it is not interposed for delay.

Dated this 17th day of September, 1957.

WALTER ELY.





APPENDIX "A."

United States Court of Appeals for the Ninth Circuit.

Centennial Insurance Company, a Corporation, Appellant, vs. Dave Schneider, Doing Business as Dave Schneider Wholesale Jewelry, Appellee. No. 15,337, Aug. 20, 1957.

Appeal from the United States District Court for the Southern District of California, Central Division.

Before: STEPHENS, Chief Judge, BONE and CHAMBERS, Circuit Judges.

BONE, Circuit Judge.

Centennial Insurance Co. (hereinafter "Centennial"), defendant below, appeals from a judgment entered by the District Court. The action was brought by Dave Schneider, doing business as Dave Schneider Wholesale Jewelry, to recover on a policy of insurance issued by Centennial to appellee on August 15, 1954, and continuing in force for a period of one year. The claimed loss of jewelry and their carrying cases allegedly covered by the policy occurred on December 3, 1954.

On the morning of December 3, 1954, at about 10:00 A.M. appellee left his place of business. As a wholesale jeweler appellee traveled by car from retailer to retailer, carrying the jewelry to be displayed in two specially fitted cases which he carried in the trunk of his car. Following his lunch, he drove to Bruce Jewelers in Inglewood, California, removed the cases from the trunk of his car, took them into the jewelry store, displayed his line of jewelry, returned the cases to the trunk, and drove to Joy Jewelry Company, also in Inglewood.

Appellee did not remove his cases at Joy Jewelry Co. He did not enter the premises, but talked with one of the buyers at Joy, Mr. Stelzer, in front of the store so he could see his car. Appellee and Stelzer got into appellee's car, drove around the block and into a blind alley and parked appellee's car behind a new car (a Ford and hereinafter called "Ford") purchased by Stelzer for his wife. Both appellee and buyer apparently got into the Ford car, the buyer then showing appellee the dashboard equipment. Appellee testified he had locked his car, and adjusted the rear view mirror of the Ford so that he could see his car. The inspection of the Ford lasted from five to fifteen minutes. Appellee then returned to his car and drove about four miles to the store of another customer, California Premium Service.

The drive to California Premium Service took some forty-five minutes because of heavy traffic at that hour. Appellee parked his car close to California Premium Service and claims that he watched it at all times while talking to Mr. Nigro of California Premium Service, except for about one minute when he examined a diamond, and during this time Mr. Nigro watched appellee's car. It was after inspecting the diamond that appellee opened the car trunk to remove his cases, and found both cases were not there. Centennial was notified and the police called.

Appellee's car was a 1954 Cadillac Coup de Ville model. The trunk latch locked automatically when the trunk door or lid was closed. The trunk latch showed no evidence of tampering. The trunk lid was of the type which rises if not latched shut because of a spring mechanism. Testimony was conflicting as to how high the trunk lid would have to rise or would have to be raised up for appellee to notice it by looking into the rear view mirror. At trial

appellee testified it would have to be up all the way for him to see it in his rear view mirror. The jewelry cases were about 4½ feet tall, 2½ feet wide and 20 inches in depth, weighed about 25 pounds when empty, and about 65 pounds (counting the jewelry contents) on the day in question. Each case was on wheels to facilitate moving it. Counsel for Centennial elicited by questioning at trial (and strongly emphasizes in its brief in this Court) that between the time he left his place of business at 10:00 A.M. and the time he discovered the loss of the jewelry, about 4:30-5:00 P.M., appellee made no use of a rest room, the implication being that appellee probably did make use of a rest room during this seven hour period, forgot about it, and that it was during this time when the car would be out of his sight that the theft was committed.

Both parties seem to entertain the view that the loss was a result of a *theft*, and the District Judge found the jewelry to have been *stolen*. Major controversy centers on clause 5(I) of the policy, which reads:

“5. This policy insures against all risks of *loss of or damage to* the above described property arising from any cause whatsoever *except*:

* * * * *

“(I) *Loss or damage to property insured hereunder while in or upon any automobile, motorcycle or any other vehicle unless, at the time the loss occurs, there is actually in or upon such vehicle, the Assured, or a permanent employee of the Assured, or a person whose sole duty it is to attend the vehicle.* This exclusion shall not apply to property in the custody of a carrier mentioned in Section 2 hereof, or in the custody of the Post Office Department as first class registered mail.” (Emphasis supplied.)

Appellee argues that the language in the exception clause, (I), “* * * loss or damage to property while in or upon an automobile * * *,” is ambiguous, and should be construed most strongly against Centennial. Appellee also asserts that “* * * loss or damage to property * * *” can mean only *damage to* property and does not include *theft* as a theft involves “loss of” property rather than “loss * * * to” property. Thus, says appellee, the exception clause does not apply in this case. This is a clever argument, and is indicative of the thoroughness with which counsel has represented appellee. However, we cannot accept the argument. We believe the language of the policy excepting “*loss or damage to* property” expresses the intention to except *theft of* property from an automobile on the terms therein stated, and not alone to except *damage to* property (assuming damage means something entirely different from theft). We are supported in this view by other decisions which have found similar language to be reasonably clear and unambiguous, and applied such language to cases of theft. Cf. *Greenberg v. Rhode Island Ins. Co.*, 1946, 66 N. Y. S. 2d 457, 459; *Princess Ring Co., Inc. v. Home Ins. Co.*, 1932, 52 R. I. 481, 161 Atl. 292, 293.

It is appellee’s further contention that direct testimonial evidence shows that the insured property was not taken from the car while appellee was out of the car since at all such times the car was watched and no one watching saw anyone open the trunk. From this appellee argues that he not only must have been, but that he was, in the car at the time of the theft. This apparently was the view of the trial judge as findings were made that the “* * * jewelry and sample cases and trays were stolen from the trunk of plaintiff’s automobile at a time when the plaintiff was in such vehicle.”

While testifying, appellee, over objection of Centennial's counsel, gave as his opinion to explain the occurrence of the loss, that it probably happened during the time that appellee was driving to California Premium Service after leaving Stelzer following examination of Stelzer's Ford. The traffic moved slowly, there were many stops. Appellee was of the opinion the thief (or thieves) somehow removed the cases and contents while his car was stopped, loaded them into another vehicle and made a getaway.

Centennial asserts that such a view of the "theft" must be rejected as "inherently incredible"; that the theft could not have happened while appellee was in the car without appellee being aware of its commission.

Under Rule 52(a) of the Fed. Rules Civ. Proc., a finding is clearly erroneous when, although there is evidence to support it, a reviewing court on reviewing the entire evidence is left with a definite and firm conviction that a mistake has been made. *United States v. Gypsum Co.*, 1948, 333 U. S. 364, 395-396; *Smyth, Collector of Internal Revenue v. Erickson*, 1955, 9 Cir., 221 F. 2d 1, 4; *Alaska Freight Lines v. Harry*, 1955, 9 Cir., 220 F. 2d 272, 275. Cf. *United States of America v. One 1950 Buick Sedan*, 1956, 3 Cir., 231 F. 2d 219, 223, on drawing reasonable inferences from "basic facts."

After a complete study of the evidence we are left with the conviction that a mistake has been made. We reach this conclusion for two reasons. In the first instance, the testimonial evidence is not convincing that appellee or others with whom he did business that day could adequately *see* the trunk of the car at all times. Of particular interest is the testimony concerning the several minutes that appellee was inside the Ford examining it with Stelzer

of Joy Jewelry Co. If we take the testimony most favorable to appellee (as we are required to do) *United States of America v. Comstock Extension Mining Co., Inc., et al.*, 1954, 9 Cir., 214 F. 2d 400, 403, we find these facts: the Stelzer Ford was parked in a blind alley; the front of appellee's Cadillac was parked closely behind the rear of the Ford; the rear end of the Cadillac was about parallel with the sidewalk running along a street which ran at right angles to the alley; appellee was in the front seat of the new Ford car attempting to watch the trunk of his car by looking into the rear view mirror while he also looked at the instrument panel of the Ford and talked with Stelzer; appellee testified that he couldn't see the back of his car "* * * very well, because the back was quite a ways back * * *;" appellee looked into the rear view mirror "* * * off and on * * *" as Stelzer showed him the panel in the Ford; appellee spent (by the most favorable testimony) five to seven minutes in the Ford.

We believe this testimony substantially derogates from appellee's insistence that he could see his car at all times. These facts are specially significant when considered with that part of appellee's theory which postulates that the thief (or thieves) in some way had procured a key which fitted the lock and could open the trunk with ease and dispatch. With a key to expedite opening, and with appellee having a poor view of the trunk, the trunk could have been opened, raised to a height sufficient to remove the cases, the theft completed and the getaway made without appellee being conscious of the crime. We believe that Centennial has shown by appellee's testimony that he did not always have a clear view of his car when not in it, so that the theft could have been committed while appellee

was not in the car and without appellee knowing of or seeing its commission.

We also believe that it is most doubtful that the two cases with their contents could have been removed from the trunk while appellee was in the car without appellee being aware at the time that a theft was taking place, though he might not have been able to prevent its completion. We must remember that each case measured $4\frac{1}{2}$ feet tall, $2\frac{1}{2}$ feet wide and 20 inches deep, and weighed (with contents) sixty-five pounds each. Each case was in the trunk of an automobile so that the trunk lid would have to be raised to remove it. Evidence is not clear as to how high the trunk lid would have to be raised, but it would have to be raised at least 20 inches, as this is the minimum measurement of the cases. Probably the trunk would be opened wider so the thief (or thieves) could more easily take hold of the cases and remove them without dragging them across the car frame and edge of the trunk, which would shake the vehicle, make considerable noise, and alert the driver. And when a sixty-five pound weight is removed from the rear of a car, the car probably would move or sway sufficiently to arouse the driver to the fact that something is happening to his car; he will look about. And further, the thief (or thieves) must have shut the trunk with sufficient force to lock it shut as appellee testified that if not latched properly the trunk lid would rise, especially if he drove. Appellee testified that it did not rise while he drove that day, and that it was locked when he went to remove the cases at California Premium Service. Yet, through all of these possible steps which the thief (or thieves) would have taken to complete the theft, appellee was unaware of any noise in, or unusual or surprising motions of the car.

But even if the appellee might not notice such events, drivers moving behind appellee would certainly have seen the thief (or thieves) and probably those drivers, when seeing a person (or persons) surreptitiously approach appellee's car and without any sign of approval by appellee remove two large cases and place them in another car or take them to the sidewalk, would sound their horns or call. But even if there was complete silence from all the other users of the road at that time, and even if the trunk could not be seen in the rear view mirror unless raised to its maximum height, the thief (or thieves) would have had to carry or wheel the cases to the sidewalk or to another vehicle, which would have given appellee an excellent opportunity to see at least part of the commission of the crime. A person (or persons) walking about in a busy street, even if traffic is temporarily halted, carrying or wheeling large cases would attract attention.

But the basic theory of appellee is that the theft was committed by removing the cases from his car and placing them in a getaway car while appellee was held up by slow moving traffic. This directly conflicts with appellee's theory that the crime was accomplished this way so that a fast escape could be made. If traffic was "bumper to bumper," (as appellee testified) so that appellee could not move speedily, it seems clear that a speedy getaway of the thieves would be impossible.

Centennial has shown by the testimony of appellee himself that he could not see his car clearly at all times when he was out of it. This overcomes appellee's assertion that the theft was committed while appellee was in the car as he could observe the car at all times and no one removed anything from the trunk while he watched it. And we believe that appellee's own theory of the theft is incredible.

After reviewing the entire record we entertain the firm and definite conviction that a mistake was made by the trial court. On the basis of all the evidence in this case, we believe that in finding that the jewelry was stolen from the car trunk at a time when appellee was in such vehicle, the lower court bridged an impassable chasm with an assumption.

The cause is remanded to the District Court with instructions to vacate the judgment and to enter judgment that appellee take nothing.

(Endorsed:) Opinion. Filed Aug. 20, 1957.

Paul P. O'Brien, Clerk.

APPENDIX "B."

JEWELERS' BLOCK FLOATER

Attached to and forming part of Policy Number 2WF 4871 issued to Dave Schneider dba Dave Schneider Wholesale Jewelry. Amount \$40,000.00. Premium \$597.21.

1. IN CONSIDERATION OF the premium above specified, and of the Proposal(s) and Declaration (s) dated the 15th day of August, 1954, attached hereto and made a part hereof and which is (are) hereby agreed to be the basis of this policy, and which the Assured hereby warrants to be true as to each and every statement and particular contained therein,

THIS COMPANY DOES INSURE:

Dave Schneider dba Dave Schneider Wholesale Jewelry, herein called the Assured, whose address is 205 East Broadway, Long Beach, California and whose premises are located at same from the 15th day of August 1954 to the 15th day of August 1955 both days at noon, standard time at place of issuance.

LIMITATIONS OF LIABILITY

2. The maximum liability of the Company resulting from any one loss, disaster or casualty is limited to

(A) \$40,000.00 in respect of property at the Assured's premises as described herein;

(B) \$20,000.00 in respect of property which is (1) in transit by first class registered mail, or railway express (subject to the stipulations of Exclusion (E) of Section 5), or by armored car service; (2) deposited in the safe or vault of a bank or safe deposit company; (3)

in the custody of a dealer in property of the kind insured hereunder not employed by or associated with the Assured, but property deposited for safe keeping with such a dealer by the Assured or its authorized representatives while traveling is subject to the limit expressed in Clause E of this Section;

(C) \$2,000.00 in respect of shipments by first class registered air mail or air express (subject to the stipulations of Exclusion (E) of Section 5) sent to any one addressee at any one address during any one day;

(D) \$500.00 in respect of shipments in transit by customer parcel delivery service and the parcel transportation service of railroads, waterborne or air carriers and passenger bus lines (subject to the stipulations of Exclusion (E) of Section 5);

(E) \$15,000.00 in respect of property elsewhere and not included in Clauses (A), (B), (C) and (D) above or otherwise limited herein.

PROPERTY INSURED

3. The Property Insured is as Follows:

(a) Pearls, precious and semi-precious stones, jewels, jewelry, watches and watch movements, gold, silver, platinum, other precious metals, and alloys and other stock usual to the conduct of the Assured's business, owned by the Assured.

(b) Property as above described, delivered or entrusted to the Assured by others who are not dealers in such property or otherwise engaged in the jewelry trade;

(c) Property, as above described, delivered or entrusted to the Assured by others who are dealers in such property or otherwise engaged in the jewelry trade, but

only to the extent of the Assured's own actual interest therein because of money actually advanced thereon, or legal liability for loss of or damage thereto.

TERRITORIAL LIMITS

4. The property described above is covered anywhere in, and in transit within and between, the Continental United States of America, Alaska, Canada, the Hawaiian Islands and Puerto Rico, but subject always to the limitations, conditions, exclusions and exceptions stated herein.

INSURING CONDITIONS

5. This policy insures against all risks of loss of or damage to the above described property arising from any cause whatsoever except:

(A) Loss, damage or expense caused by or resulting from sabotage, theft, conversion or other act or omission of a dishonest character (1) on the part of the Assured or his or their employees, or (2) on the part of any person to whom the property hereby insured may be delivered or entrusted by whomsoever for any purpose whatsoever, unless such loss arises while the goods are deposited for safe custody by the Assured, officer of the corporation, member of the firm or salesman while traveling, or while the goods are in the custody of (a) the Post Office Department as first class registered mail, or (b) a carrier mentioned in Section 2, or (c) a person serving as a mere porter or helper not on the payroll of the Assured.

(B) Loss or damage caused by delay, loss of marker, gradual deterioration, moth, vermin, inherent vice or insufficient or defective packing, or damage sustained while the property is being actually worked upon and directly resulting therefrom.

(C) Loss or damage caused by or resulting from

(1) hostile or warlike action in time of peace or war, including action in hindering, combating or defending against an actual, impending or expected attack, (a) by any government or sovereign power (de jure or de facto), or by any authority maintaining or using military, naval or air forces; or (b) by military, naval or air forces; or (c) by an agent of any such government, power, authority or forces;

(2) any weapon of war employing atomic fission or radioactive force whether in time of peace or war;

(3) insurrection, rebellion, revolution, civil war, usurped power, or action taken by governmental authority in hindering, combating or defending against such an occurrence, seizure or destruction under quarantine or customs regulations, confiscation by order of any government or public authority, or risks of contraband or illegal transportation or trade.

(D) Loss or damage occurring at the Assured's premises as stated herein caused by or resulting from earthquake or flood (meaning rising navigable waters). However, if the peril of fire is not excluded hereunder this policy will cover fire damage occurring during or resulting from such earthquake or flood.

(E) Loss or damage occurring in course of transit to shipments by

(1) mail unless registered first class;

(2) express unless by railway express (including air division thereof) provided, however, that a package of a value of \$1,000 or more sent by the Assured, its officers, agents, servants or employees, is not covered unless it is sealed with wax or lead and unless a special declaration of value is made to the carrier amounting to not less

than 10% of the actual value of the contents of the package. In no case need such declared value exceed \$1,000;

(3) railroad, waterborne or air carriers unless under receipt of their passenger parcel transportation or baggage services;

(4) motor carriers or truckmen other than under receipt of:

(a) those operating exclusively as a customer parcel delivery service;

(b) armored car service;

(c) the parcel transportation or baggage services of passenger bus lines.

(F) Breakage of articles of a fragile or brittle nature, unless caused by fire, lightning, explosion, aircraft, vehicles, flood, earthquake, windstorm, strikers, rioters, persons taking part in labor disturbances or civil commotions, burglars, thieves or accident to the conveyance in which the property insured is being carried (but only when and to the same extent that such perils are otherwise covered under this policy).

(G) Loss or damage to goods sold on the installment plan from the time they leave the Assured's custody.

(H) Loss or damage while the property is being worn (except watches worn solely for the purpose of adjustment) by the Assured, officer of the corporation, member of the firm, director, agent, employee, servant or messenger of the Assured, or by any dealer or other person, firm or corporation engaged in the jewelry trade or by any of their officers, directors, agents, employees, servants or messengers or by any member of the family, relative or friend of any of the aforesaid, or while in their custody for such purpose.

(I) Loss or damage to property insured hereunder while in or upon any automobile, motorcycle or any other vehicle unless, at the time the loss occurs, there is actually in or upon such vehicle, the Assured, or a permanent employee of the Assured, or a person whose sole duty it is to attend the vehicle. This exclusion shall not apply to property in the custody of a carrier mentioned in Section 2 hereof, or in the custody of the Post Office Department as first class registered mail.

(J) Loss or damage to the property hereby insured while at any exhibition promoted or financially assisted by any Public Authority or by any Trade Association.

(K) Loss of or damage to property contained in show windows at the Assured's premises by theft or attempted theft accomplished by or resulting from the smashing or cutting of such windows except as may be endorsed hereon.

(L) Loss of or damage to property exhibited by the Assured in show cases or show windows elsewhere than at the premises of the Assured as referred to in this policy except as may be endorsed hereon.

(M) Unexplained loss, mysterious disappearance or loss or shortage disclosed on taking inventory. Nor shall this policy cover any shortage in goods claimed to have been forwarded in a package when the package is received by the consignee in apparent good order with seals unbroken, nor for loss of or damage to goods when sent "C.O.D." with the privilege of inspection by the consignee before delivery.

6. To the extent of 10% of the limit of liability stated in Section 2 as applicable at such premises this Company will pay for damage (except by fire) to that part of the building occupied by the Assured directly resulting from

theft or any attempt thereof provided the Assured is the owner of such premises or is legally liable for such damage, but in no event shall this section apply to glass or to any lettering or ornamentation thereon. The Company's combined liability under this section and under Item (A) of Section 2 shall not exceed the amount of insurance shown under Item (A) of Section 2 for the premises at which such loss or damage occurs.

7. No assignment of or change of interest under this policy shall bind the Company, nor shall any change in or additions to the premises of the Assured stated in this policy be covered hereunder, unless the consent of the Company shall be endorsed hereon. No agreement, condition, or declaration of this policy shall be waived or changed, except by endorsement countersigned by a duly authorized agent of the Company. No notice to, or knowledge possessed by any agent or any other person shall be held to effect a waiver or change in any part of this policy unless endorsed hereon and signed as above provided.

8. It is a condition of this insurance that

(A) The Assured will maintain a detailed and itemized inventory of his or their property and separate listing of all travelers' stocks, in such manner that the exact amount of loss can be accurately determined therefrom by the Company.

(B) The Assured will maintain during the life of this policy, insofar as is within his or their control, watchmen and the protective devices as described in his or their proposal form or in endorsements attached hereto.

9. (A) The Company shall not be liable beyond the actual cash value of the property at the time of any loss or damage and the loss or damage shall be ascertained or

estimated according to such actual cash value with proper deduction for depreciation, however caused, and shall in no event exceed the lowest figure put upon such property in the Assured's inventories, stock books, stock papers or lists existing at the time the loss occurred, nor the cost to repair or replace the same with material of like kind and quality. Any antiquarian or historical value attaching to the said property shall be excluded from the estimate of loss or damage.

(B) Claims in respect of loss of or damage to pledged articles shall be limited to the amount actually loaned and unpaid plus the interest thereon at legal rates accrued at date of loss.

10. In case of loss of or damage to property of others held by the Assured, for which claim is made upon the Company, the right to adjust such loss or damage with the owner or owners of the property is reserved to the Company and the receipt of such owner or owners in satisfaction thereof shall be in full satisfaction of any claim of the Assured for which such payment has been made. If legal proceedings be taken to enforce a claim against the Assured as respects any such loss or damage, the Company reserves the right at its option without expense to the Assured, to conduct and control the defense on behalf of and in the name of the Assured. No action of the Company in such regard shall increase the liability of the Company under this policy, nor increase the limits of liability specified in Section 2 hereof.

11. It is understood and agreed that any insurance granted herein shall not cover (excepting as to the legal liability of the Assured), when there is any other insurance which would attach if this policy had not been issued, whether such insurance be in the name of the Assured or of any other third party. It is, however, understood and

agreed, that if under the terms of such other insurance (in the absence of this policy) the liability would be for a less amount than would have been recoverable under this policy (in the absence of such other policy) then this policy attaches on the difference.

12. This insurance shall in no wise inure directly or indirectly to the benefit of any carrier or other bailee.

13. In the event of loss or damage, or of anything likely to result in a claim under this policy, the Assured shall give immediate notice in writing to the Company, protect the property from loss or damage, furnish a complete list of the lost or damaged property stating the market value and cost of each article and the amount claimed thereon; and the Assured shall within sixty (60) days after a loss (unless such time is extended in writing by the Company), render to the Company a proof of loss signed and sworn to by the Assured, stating the knowledge and belief of the Assured as to the following. The time and cause of the loss or damage, the interest of the Assured and of all others in the property affected, the cash value of each item thereof, and the amount of loss of or damage thereto, all encumbrances thereon, all other contracts of insurance, whether valid or not, covering any of such property and shall furnish a copy of all the descriptions and schedules in all such insurance policies if required.

14. The Assured as often as may be reasonably required shall submit, and so far as is within his or their power shall cause all other persons interested in the property and members of their households and employees to submit to examinations under oath by any persons named by the Company relative to any and all matters in connection with a claim and subscribe the same, and shall produce for examination all books of account, bills, in-

voices, and other vouchers or certified copies thereof if originals be lost, at such reasonable time and place as may be designated by the Company or its representatives, and shall permit extracts and copies thereof to be made. No such examination under oath or examination of books or documents, nor any other act of the Company or any of its employees or representatives in connection with the investigation of any loss or claim herein under, shall be deemed a waiver of any defense which the Company might otherwise have with respect to any such loss or claim, but all such examinations and acts shall be deemed to have been made or done without prejudice to the Company's liability.

15. There shall be no abandonment to the Company of any property but the amount of loss or damage for which the Company may be liable shall be payable sixty (60) days after satisfactory Proof of Loss as herein provided, is received by the Company.

16. It is understood and agreed that if in case of loss the Assured shall acquire any right of action against any individual, firm or corporation for loss of or damage to the property insured hereunder, the Assured will, if requested by the Company, assign and transfer such claim to the Company or, at the Company's option, execute and deliver to the Company the customary form of loan receipt, upon receiving payment for loss or advancement of funds in respect of the loss and will subrogate the Company to or will hold in trust for the Company, all rights and demands of every kind, respecting the same, to the extent of the amount paid or advanced, and will permit suit to be brought in the Assured's name at the expense of the Company.

17. In case of any loss or damage of any kind whatsoever, it shall be lawful and necessary, for the Assured or

his, or their factors, servants or assigns to sue, labor and travel for, in and about the defense, safeguard and recovery of the aforesaid subject matter of this insurance or any part thereof without prejudice to this insurance or waiver of the Assured's rights hereunder.

18. No suit, action or proceeding for the recovery of any claim under this policy shall be sustainable in any court of law or equity unless the same be commenced within twelve (12) months next after discovery by the Assured of the occurrence which gives rise to the claim. Provided, however, that if by the laws of the State within which this policy is issued such limitation is invalid, then any such claims shall be void unless such action, suit or proceeding be commenced within the shortest limit of time permitted by the laws of such State to be fixed herein.

19. It is agreed that the sum hereby insured shall be reduced by the amount of any loss covered by this policy, and that the maximum limits of liability applicable to the loss, shall likewise be reduced by the amount of all losses. Such reductions shall take effect as of the date of the occurrence from which the loss arises. The amount of loss, for the purpose of this clause, shall include any amount due to the Assured and any sums paid as rewards for the recovery of insured property, or otherwise. However, the full amount insured shall be reinstated automatically and a pro rata additional premium shall be payable from the date of the occurrence. Pending adjustment of any loss, payment of the premium for reinstatement of the amount thereof may be deferred until the amount of the loss has been fixed and the precise amount of the reinstatement premium is known.

20. This entire policy shall be void if the Assured has concealed or misrepresented any material fact or circumstance concerning this insurance or the subject hereof or

in case of any fraud, attempted fraud or false swearing by the Assured touching any matter relating to this insurance or the subject thereof, whether before or after a loss.

21. This policy may be canceled by the Assured by mailing to the Company written notice stating when thereafter such cancellation shall be effective. This policy may be canceled by the Company by mailing to the Assured at the address shown in this policy or last known address written notice stating when not less than five (5) days thereafter such cancellation shall be effective. The mailing of notice as aforesaid shall be sufficient proof of notice and the effective date of cancellation stated in the notice shall become the end of the policy period. Delivery of such written notice either by the Assured or by the Company shall be equivalent to mailing. If the Assured cancels, earned premiums shall be computed in accordance with the customary short rate table and procedure. If the Company cancels, earned premiums shall be computed pro rata. Premium adjustment may be made at the time cancellation is effected and, if not then made, shall be made as soon as practicable after cancellation becomes effective. The Company's check or the check of its representative mailed or delivered as aforesaid shall be a sufficient tender of any refund of premium due to the Assured.

22. Terms of this policy which are in conflict with the statutes of the State wherein this policy is issued are hereby amended to conform to such statutes.

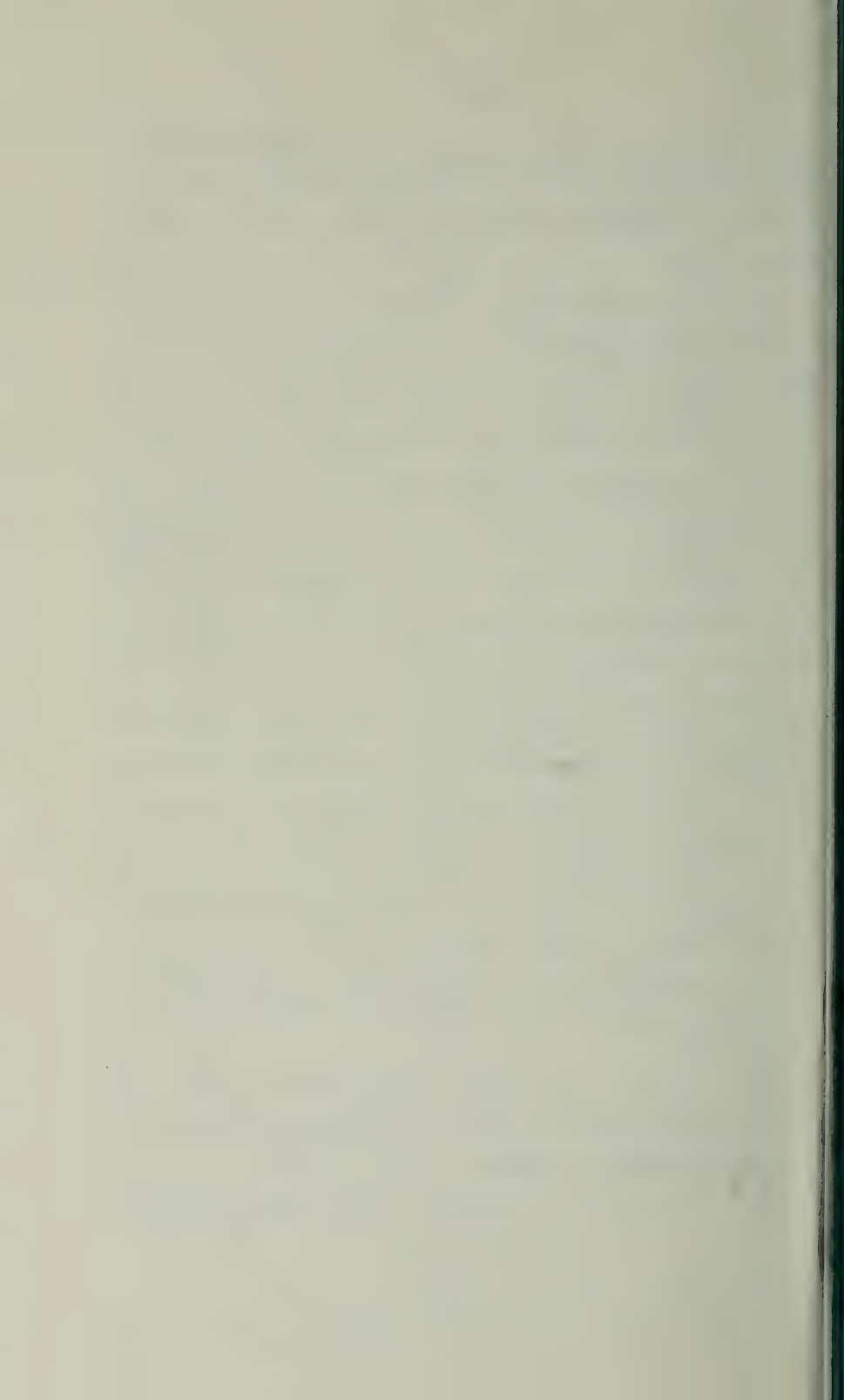
(Signed) Jack Grand Agent.

Jack Grand

Insurance

Heartwell Bldg.

Long Beach 2, Calif.



No. 15,338

IN THE

United States Court of Appeals
For the Ninth Circuit

ALTHEA G. WILLIAMS,

Appellant,

vs.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

HENRY C. CLAUSEN,

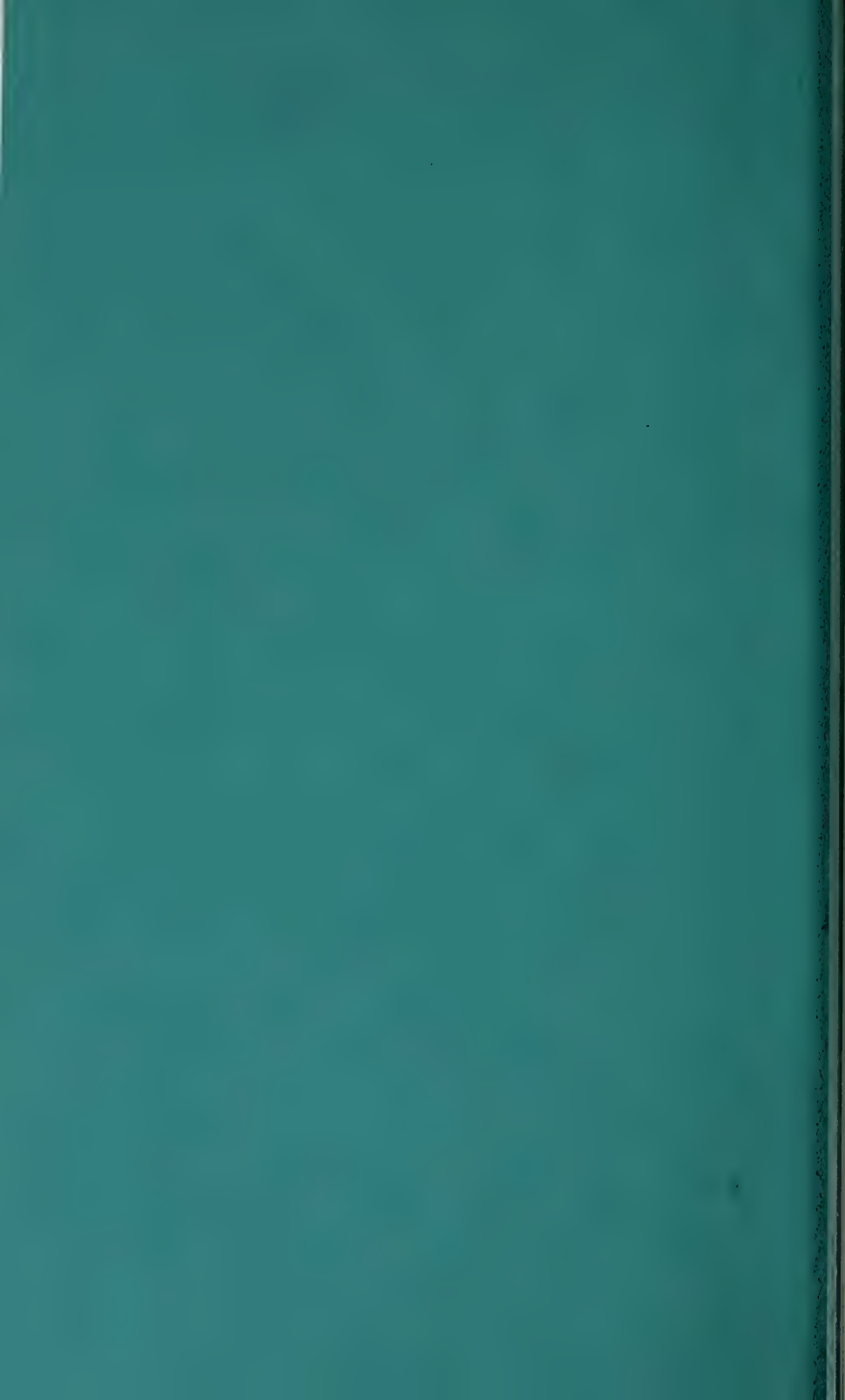
315 Montgomery Street, San Francisco 4, California,

Attorney for Appellant.

FILED

MAR 13 1957

PAUL P. O'BRIEN, CLERK



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No. 15,338

IN THE

**United States Court of Appeals
For the Ninth Circuit**

ALTHEA G. WILLIAMS,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S OPENING BRIEF.

JURISDICTIONAL STATEMENT.

Plaintiff filed a complaint under the Federal Tort Claims Act against the United States of America for damages for personal injuries (R. 1*). The District Court had jurisdiction under 28 U.S.C., §1346(b). The case was first tried before Chief Judge Roche, whose memorandum opinion is reported at 105 F. Supp. 208. Judgment originally went against plaintiff and for defendant (R. 52). Thereupon an appeal was had to this Court (R. 53), and the judgment of the District Court was affirmed (R. 183). The opinion of

*Record references throughout this brief will be as follows: "R." shall refer to the printed record before the U. S. Supreme Court; "T.R." shall refer to the typewritten record on this appeal.

this Court is reported in 215 F. 2d 800. Plaintiff thereupon petitioned the United States Supreme Court for a Writ of Certiorari, which petition was granted (R. 183). The United States Supreme Court then issued its mandate, vacating the judgment of the Court of Appeals and remanding the case to the District Court for reconsideration (T.R. 1). Its opinion is reported at 350 U.S. 857.

Plaintiff accordingly moved the District Court for judgment or for new trial (T.R. 2). This motion was denied (T.R. 16) and the District Court on July 12, 1956, gave judgment to defendant and dismissed plaintiff's complaint (T.R. 15, 16). Judge Roche's second memorandum opinion is reported at 141 F.S. 851. Plaintiff filed her Notice of Appeal to this Court on July 25, 1956 (T.R. 17). This Court has jurisdiction to review the judgment under 28 U.S.C. §1291.

STATEMENT OF THE CASE.

Plaintiff filed her complaint in the District Court under the Federal Tort Claims Act to recover damages for severe and painful permanent injuries sustained through the negligent driving of a United States Government vehicle by a soldier on the Island of Guam (R. 1). Plaintiff contends that the soldier was acting within the scope of his employment at the time of the accident. The respondent United States filed an answer denying all allegations as to negligence, scope of employment, causation, injuries, and amount of damages (R. 6).

Prior to filing its answer, respondent moved for a summary judgment on the grounds that the soldier at the time of the accident was not acting in the line of duty nor in the course of employment by the United States (R. 3).

Reference was made in the motion to records on file in respondent's San Francisco office. Plaintiff filed her affidavit in opposition to the motion, stating that at the trial she would develop the liability of respondent based upon these facts: The vehicle driven by the soldier and which caused injuries to plaintiff was an Army weapons carrier owned by the respondent. There had been delivered to the soldier, for recreational purposes, a pass and a trip ticket issued for the vehicle, permitting him to drive respondent's vehicle. The soldier driver thus was covered under the umbrella of an authorized recreational status. Such status was in the interest of the respondent employer for morale maintenance of the soldier. The Army procedure and custom in effect at the time and place, including what was done in this case, namely, the trip ticket and the permission of respondent to drive the vehicle assumed that the recreational driving at the said time and place was in the nature of authorized Army activities. Respondent had clothed the soldier's driving with official sanction and had granted him express permission to drive the vehicle. In that sense his trip was actually official business (R. 4).

The District Court, after hearing, denied respondent's motion for summary judgment (R. 4-5).

The evidence at the trial was as follows:

The accident occurred on the evening of March 3, 1949, at about 10:30 o'clock P.M. (R. 58). Plaintiff was sitting in another U. S. Army vehicle, parked at the end of the Breakwater Road at the town of Agana on the Island of Guam (R. 58). Plaintiff's vehicle was struck by a $\frac{3}{4}$ -ton Army weapons carrier being driven by Corporal Joe Seabourn of the United States Army (R. 61). Plaintiff was seriously and permanently injured (R. 35-36, 39-40).

Soldiers stationed on Guam technically were on duty 24 hours per day (R. 30). At the time of the accident, Seabourn was a supply clerk stationed on Guam with a service detachment (R. 27). In the performance of his duties, he occasionally drove an Army weapons carrier (R. 27). On March 3, 1949, he had been issued an Army operator's permit for any vehicle up to $2\frac{1}{2}$ tons (R. 27).

About 8:00 A.M. on the day of the collision, Seabourn, while on authorized pass for recreation (R. 27), and two other soldier buddies, also on pass—Sgt. Vincent and Pfc. Schmidt—went to a tavern about a mile from Harmon Field and spent most of the morning drinking (R. 132). In the afternoon, the three hired a cab and went about Agana, drinking, until 6:30 P.M. when they returned to the base (R. 132).

At 8:00 P.M. Seabourn, still on authorized pass, went to Sgt. Stiles of his company and obtained for recreational use, with knowledge of all concerned and in accordance with the Army custom, an official

"trip ticket" for a $\frac{3}{4}$ -ton weapons carrier assigned to the 374th T.C.W. (R. 129,28). The trip ticket was good for that vehicle until 9:30 A.M. the next day. (It was made out to Pfc. Carbera [R. 28]).

Seabourn and his companion, Pfc. Richard Schmidt, both testified that trip tickets for vehicles in service stock always were passed around between the men working in that section, regardless of the name of the individual to whom the trip ticket was made out (R. 126). This was the usual procedure (R. 127); and it applied whether the vehicle was to be used for work or recreation.

Vehicles were necessary for recreational purposes in view of the distances on Guam between station points and the authorized Army recreational facilities (R. 127). All officers and enlisted men in Seabourn's unit followed the practice of thus circulating trip tickets (R. 131).

Thus, Seabourn's superior officers had jeeps. The enlisted men, as did Seabourn on the occasion in question, used weapons carriers (R. 131).

This practice had prevailed on Guam for at least fifteen months prior to the accident (R. 130).

Having at 8:00 P.M. on the day in question obtained the official trip ticket authorization, the proper authorities at the motor pool gave Seabourn the weapons carrier (R. 128). After this, he and his two companions, he driving the vehicle, checked out of the base at the motor pool dispatch station, in the usual manner. They then went to the official Army

NCO Recreational Club and from there to Agana (R. 128). Neither Schmidt nor Vincent drove the carrier. They left Seabourn before the collision (R. 132).

The District Court for the Northern District of California, Southern Division, found that petitioner suffered severe bodily injuries as a result of the accident; that the accident was entirely due to the negligence of the soldier; that the soldier was, at the time of the accident, off duty; that the soldier had obtained unauthorized possession of the vehicle; that the soldier's use of the vehicle was not for a purpose authorized by his commanding officer; that the soldier was merely off on a frolic of his own; and the Court concluded that the soldier, an employee of respondent, was not acting within the course and scope of his employment (R. 50).

The first Memorandum Opinion, filed by the Honorable Judge Roche on June 4, 1952, contains an erroneous statement of fact. The opinion states (R. 45):

“On the other hand Sgt. Stiles states that the vehicle was to be used for official business only; that because the vehicle was on 24 hours dispatch and was used officially by all men in the Section who had permits; that it was good on the post only.”

This statement is based on the affidavit of Sgt. Stiles (R. 155). But this affidavit was admitted subject to a motion to strike, which motion was granted (R. 48). Since on reconsideration there was no fur-

ther evidence adduced there still is no basis whatsoever for the trial court's opinion.

An important portion of the memorandum opinion follows:

"Even assuming that the practice testified to by Seabourn and Schmidt was known and permitted by the officer in charge, it would not make the United States liable. . . By the Tort Claims Act the United States has consented to be sued for the negligence of its employees only when they are acting within the scope of their employment which, in the case of military personnel, means acting in the line of duty. To determine whether the person inflicting the injury was an employee so acting, we look to Federal law and decisions. . ." (R. 45.)

On October 22, 1952, judgment was entered for respondent. On November 21, 1952, plaintiff filed her Notice of Appeal (R. 53). On September 8, 1954, the Ninth Circuit filed its opinion, affirming the judgment below (R. 168). Important portions of this opinion follow:

"We disagree with appellant's contention that our decision in *Murphey v. United States*, supra, when laid off against the facts revealed by the record before us, is dispositive of the vital and controlling issue in the instant case. We are fully persuaded that the *Murphey* case is clearly distinguishable on the facts. . ." (R. 174.)

* * * * *

"As we point out herein, one important problem was met and disposed of by a specific provision in the Act which carefully delimited the area of

federal liability for a tortious act of (as here) a soldier, by providing that such liability would attach *only* when the act was committed while the soldier was 'acting in the line of [military] duty.' This careful delineation provides a clear line of demarcation between Government liability for a soldier's torts and the area of general liability of a private employer for torts of his employees in classical 'master and servant' cases where the rule of respondeat superior is normally applied..." (R. 177-178.)

* * * * *

"... as to ... civilian employees, the familiar doctrine of respondeat superior, as it has been applied under California law to the commonplace 'master and servant' cases, would apply. But in dealing with the problem of federal liability for tortious acts of members of the military and naval forces a wholly different situation is presented because Congress saw fit to adopt a drastic modification of this 'master and servant' doctrine..." (R. 178-179).

Plaintiff thereupon petitioned the U. S. Supreme Court for a Writ of Certiorari, which was granted (R. 183). After briefing and oral argument, the Supreme Court issued its mandate as follows:

"On consideration whereof, It is ordered and adjudged by this Court that the judgment of the said United States Court of Appeals, in this cause be, and the same is hereby vacated, the case being controlled by the California doctrine of respondeat superior, and this cause be, and the same is hereby remanded to the United States District Court for the Northern District of Cali-

fornia for consideration in the light of that governing principle." (T.R. 1).

Plaintiff thereupon made her motion for judgment, or, in the alternative, for a new trial (T.R. 2). This motion was denied, the court holding that Corporal Seabourn was not acting within the scope of his employment, and judgment was entered in favor of defendant upon the Findings of Fact set forth in its memorandum opinion and the Findings of Fact theretofore made and filed October 21, 1952, which were expressly readopted (T.R. 15). Judgment was entered July 12, 1956, and plaintiff appealed on July 25, 1956.

SPECIFICATION OF ERRORS.

- 1. THE TRIAL COURT ERRED IN FINDING THAT SEABOURN OBTAINED UNAUTHORIZED POSSESSION OF THE WEAPONS-CARRIER.**

This finding is erroneous in that the uncontradicted evidence is that Seabourn obtained possession of the weapons-carrier for purposes sanctioned by and in accordance with the long-established army custom, practice and standard operating procedure.

- 2. THE TRIAL COURT ERRED IN FINDING THAT SEABOURN WAS ON A FROLIC OF HIS OWN AND WAS NOT ACTING WITHIN THE SCOPE OF HIS EMPLOYMENT.**

This finding is erroneous for these reasons: First, the accident occurred while Seabourn was engaged in a series of authorized acts, namely, driving the vehicle

for recreation and transporting himself and other personnel to and from the recreation facilities provided for by the government, the NCO Club; and Second, these authorized acts were, under the peculiar circumstances of Seabourn's overseas service, for a governmental purpose, the improvement of morale; and as such, under the rule of this Circuit in *Murphey v. U.S.*, 179 Fed. 2d 743, were done within the scope of Seabourn's employment. The rule of the *Murphey* case has been reaffirmed by the U.S. Supreme Court in this very case.

ARGUMENT.

I. THE TRIAL COURT'S FINDING THAT SEABOURN OBTAINED UNAUTHORIZED POSSESSION OF THE WEAPONS-CARRIER IS CONTRARY TO LAW AND THE EVIDENCE. THIS COURT SHOULD MAKE THE CONVERSE FINDING.

By merely repeating the findings it previously made prior to the remand of the U.S. Supreme Court, the District Court has compounded its previous errors and now forces plaintiff to argue twice almost the same contentions which led the Supreme Court once to reverse in her favor. The most important of these contentions relates to the issue of Seabourn's authority to use the army vehicle for recreation. The finding of fact (R. 51) that Seabourn obtained unauthorized possession of the weapons-carrier was the basic reversible error in the trial court's first judgment. The government's liability rests on the true fact to the contrary. Seabourn *was* authorized to use the weapons-carrier for recreation.

There can be no question of proof of Seabourn's authority so to use the vehicle. The evidence is uncontradicted. (The only contradiction appears in an affidavit of a Sergeant Stiles which on motion of plaintiff was stricken from the record. [R. 48].) Under a long-standing custom, practice, and standard operating procedure of the military on Guam, the vehicle, if not in use for other army business, was driven at night by members of Corporal Seabourn's detachment for recreational purposes.

"Q. State whether that was the usual procedure, whether the use of the vehicle was official business or recreation of the individual using it.

A. Well, everybody who drove it used it for the same thing I was using it for. When they weren't using it in service stock they drove it at night." (R. 28, Deposition of Seabourn.)

"Q. State whether the trip ticket in question while issued therefor for official business was by this usual procedure also for your use of the vehicle for recreation.

A. If there was a trip ticket the vehicle could have been used for official business or for recreation." (R. 9, Deposition of Schmidt.)

"Q. State the individuals in your section who followed that procedure, including officers and enlisted men.

A. All the men in the Section used the trucks and some of the men that I remember who were in my section were PFC Jack Slinker, Sgt. Raphael Herrera and Lt. John Reese, the same ones I mentioned before." (R. 13, Deposition of Schmidt.)

“Q. State the individuals in your Section who followed that procedure, including officers and enlisted men.

A. Well, sir, everybody, all the officers had a jeep assigned to them. They drove them and the enlisted men had three weapons carriers, I believe, to use. There was Lt. Luther, he had a jeep assigned to him, and Lt. Werb, he had a jeep assigned to him. The other two weapons carriers, I don't remember who drove them but I know they drove them at night.” (R. 31-32, Deposition of Seabourn.)

It was also part of that custom, practice and standard operating procedure for the military individual in securing the vehicle for recreation to proceed to the motor pool, ask for the truck, drive it to the dispatcher at the dispatch window and receive a trip ticket. Apparently, rather than reissue a new trip ticket each time the truck was released, the same trip ticket would be passed around from new driver to new driver. This was done by Corporal Seabourn on the night in question.

“Q. When you set forth in your statement, ‘The trip ticket was good for that vehicle until 9:30 a.m. Friday, March 4,’ state the mode or method of obtaining such a trip ticket, and by whom it was issued.

A. Well, sir, I don't remember whether they had let us out on 24-hour dispatch. I don't remember if it was issued. We just went to the motor pool and asked them for the truck if it wasn't out to the Section and drove it to the window and they would give you the trip ticket.” (R. 31, Deposition of Seabourn.)

“Q. When Seabourn sets forth in his statement, ‘the trip ticket was good for that vehicle until 9:30 a.m. Friday, March 4’ state the mode or method of obtaining such a trip ticket, and by whom it was issued.

A. I don’t know who issued the trip ticket which Seabourn had if he had one, but the method of obtaining trip tickets was to take the vehicle, which was kept in the squadron area, down to the dispatch office and obtain a trip ticket from the dispatcher who was on duty. There was a dispatcher on duty 24 hours a day.” (R. 12, Deposition of Schmidt.)

“Q. Is it correct, is it not, that the trip tickets including the said trip ticket mentioned, in service stock were always passed around between the men working in that Section, regardless of the name of the individual to whom the trip ticket was made out?

A. Yes sir, that is correct, although I don’t know if this vehicle had a trip ticket.” (R. 9, Deposition of Schmidt.)

“Q. Is it correct, is it not, that the trip tickets, including the said trip ticket mentioned, in service stock were always passed around between the men working in that Section, regardless of the name of the individual to whom the trip ticket was made out?

A. Yes, Sir.” (R. 28, Deposition of Seabourn.)

“Q. Is it not a fact that when you got back at that time you got a trip ticket for the said weapons carrier assigned to the 374th T.C.W.?

A. Yes, Sir.

Q. Is it not true that you picked up this trip ticket from Sergeant Stiles of your company?

A. Yes, Sir." (R. 28, Deposition of Seabourn.)

"Q. Is it not a fact that when he got back at that time he got a trip ticket for the said weapons carrier assigned to the 374th T.C.W.?

A. Yes, he picked up a trip ticket for the said weapons carrier." (R. 18, Deposition of Vincent.)

The above custom, practice and standard operating procedure had existed in Seabourn's Detachment *for at least a year and three months before the accident.*

"Q. For how long a period to your knowledge was the procedure, noted above, with respect to the mode and method of trip tickets in effect on the Island of Guam?

A. Well, Sir, I don't know that. Everything, as far as I know was always the same since I got here." (R. 30, Deposition of Seabourn.)

"Q. For how long a period of your knowledge was the procedure, noted above, with respect to the mode and method of trip tickets covering Army motor vehicles, in effect on the Island of Guam?

A. As long as I was over there, and I was over there for about fifteen months, as of March 3, 1949." (R. 11, Deposition of Schmidt.)

Lieutenant Werb, Seabourn's commanding officer (R. 16), also used this procedure.

"Q. Give the names, rank, grade and stations of the various people in the United States Armed Forces who, to your knowledge, authorized or followed the noted mode and method of trip tickets and procedure, prior to the date of the collision.

A. Everyone in my outfit used this procedure. . ." (R. 11-12, Deposition of Schmidt.)

"Q. State the individuals in your Section who followed this procedure, including officers and enlisted men.

A. Well, Sir, everybody. . . There was Lt. Luther, he had a jeep assigned to him, and Lt. Werb, he had a jeep assigned to him. . ." (R. 32, Deposition of Seabourn.)

As noted above Corporal Seabourn followed the custom, practice, standard operating procedure in securing the weapons-carrier, and his purpose was the purpose sanctioned by this custom.

"Q. What was his purpose in using that weapon's carrier, as far as you know?

A. For recreation; he wanted to go to Twentieth Air Force Headquarters, to the NCO Club there." (R. 17, Deposition of Vincent.)

Thus the trial court's finding that Seabourn had unauthorized possession of the army vehicle is factually incorrect. It is wholly without support. Possession of the vehicle was sanctioned not only by the army custom and practice, but in this case specifically by his securing a trip ticket and checking out the vehicle while the official motor pool army dispatcher. And even assuming that this army custom and practice might have technically violated some general Army

Regulations still in the eyes of the law such hyper-technicality should not and *does not affect the rights of an injured third person*. The injured third person is the exception. "Actual authority is such as a principal intentionally confers upon the agent, or intentionally, or *by want of ordinary care*, allows the agent to believe himself to possess." Calif. Civil Code § 2316. In determining whether a particular act is reasonably contemplated by the employment, "the custom and usage of a particular employment . . . should be considered." *Employers' Etc. Corp. v. Indus. Acc. Com.*, 37 C.A. 2d 567, 573. And, since the entire evidence is by way of deposition, this Court may make the proper finding that Seabourn's use *was* authorized. *Murphey v. U. S.* 179 Fed. 2d 743.

But the question of technical violation of Army Regulations is more or less moot, although the trial court continues to advert thereto (T.R. 4, 11). As respondent stated in its trial brief below, "The government's position has consistently been that it is responsible only if the enlisted man was operating the vehicle under the circumstances and conditions prescribed by Army Regulations 700-105." This was the view of this Court upon the prior appeal, wherein it erroneously held that the Government's liability was governed by "Federal law and decisions."

But appellant argued successfully before the United States Supreme Court that, assuming *arguendo*, the vehicle was not operated according to the strict terms of Army Regulations 700-105, still the government would be liable because of the injured third person.

Appellant contended, on the one hand, that the violation of an unenforced and ignored Army Regulation could not be relied upon by the government to avoid liability, for to so do would permit the government to immunize itself by the unfair device of enacting regulations bounding the scope of employment of its servants while at the same time in practice and in fact authorizing its servants to perform the proscribed acts. This would be immunity by legal fiction. And, on the other hand, appellant argued that the practice on Guam was itself evidence of authority, of permission, and of the "scope" of employment for soldiers stationed on Guam at the time of the accident. The United States Supreme Court, in our case, of course, rejected the position of the government and agreed with appellant. It held that the issue of scope of employment is governed by the California rule of respondeat superior, not federal law, decisions, or regulations, whether they were enforced or not.

II. UNDER CALIFORNIA LAW AS FOUND BY THIS COURT IN MURPHEY v. U. S., AS RECENTLY REAFFIRMED BY THE SUPREME COURT IN THIS VERY CASE, SEABOURN'S AUTHORIZED USE OF THE ARMY VEHICLE FOR RECREATION WAS WITHIN THE SCOPE OF HIS EMPLOYMENT. IT DOES NOT MATTER THAT THAT USE WAS NEGLIGENT, NOR THAT THE USE GAVE HIM PERSONAL ENJOYMENT. UNDER THE PECULIAR FACTS AND CIRCUMSTANCES OF THIS CASE, A GOVERNMENTAL PURPOSE WAS BEING SERVED WHICH FIXES LIABILITY UPON THE GOVERNMENT UNDER THE RULE OF RESPONDEAT SUPERIOR.

In its memorandum opinion, the trial court held, "Seabourn was neither 'directly or indirectly serv-

ing his master' within the scope of his employment, because he was serving only his *own personal desires* not at all connected with any recreational activities authorized by his employer" (R. 11). But in this the trial court errs.

A. Contrary to the Erroneous Finding of the Trial Court, the Specific Act of Driving the Army Vehicle for Recreation Was Itself an Authorized Act, and Consequently Seabourn's Negligence in Performing That Act Gives Rise to Governmental Liability.

Appellant asks this Court to view the bare facts of the record in the light of the actualities of overseas military service upon Guam at the time of the accident. The Island of Guam is 32 miles long and 4 to 10 miles wide. It is located at least 6,000 miles from the homes of most military personnel stationed there. The military considered the soldier at that place to be on duty 24 hours a day. Actually, in keeping with the realities of morale maintenance, soldiers were individually permitted, by going through customary channels, to use military vehicles for recreational purposes. As seen heretofore there can be no doubt that this practice prevailed, and had prevailed for many months prior to the accident.

These facts illustrate what this case is not. This is not the case where a soldier is on "stateside" pass seeking "stateside" pleasure. This is not anything like the case where a soldier on leave in the United States uses his own automobile to go to and from his home, as in *U.S. v. Eleazer*, 177 F. 2d 914. This is not the case where a flier makes unauthorized use of

an airplane in the United States and causes personal injuries, as in *King v. U.S.*, 178 F. 2d 320.

This is a case like *Murphey v. U.S.*, 179 F. 2d 743 of this circuit, and the cases and analogies cited and relied upon *by this very Court*, each of which have received the tacit approval of the United States Supreme Court *in this very case*.

1. In the Factual Context of This Case the Soldier in Using the Vehicle for His Own Recreation Was in Part Serving Governmental Purpose. The Well-Reasoned Case of *Murphey v. U. S.* Is Direct Authority to That Effect.

California law states the applicable rule as follows:

"It is the established rule in this jurisdiction that where the servant is combining his own business with that of his master, or attending to both at substantially the same time, NO NICE INQUIRY WILL BE MADE AS TO WHICH BUSINESS THE SERVANT WAS ACTUALLY ENGAGED IN WHEN A THIRD PERSON WAS INJURED; but the master will be held responsible, unless it clearly appears that the servant could not have been directly or indirectly serving his master." (Emphasis added.)

Ryan v. Farrell, 208 Cal. 200.

In the case at bar we have a seriously injured third person. Do we have an individual soldier who was combining his own business with that of his master? The *Murphey* case of this Circuit holds that we do. The rationale of its holding may be stated as follows: When the type of employment is such that the employee is almost constantly under the employer's wing;

when the employee is peculiarly isolated from the usual recreational pursuits; when the employer has unusual control over the hours, area, or instrumentality in which off-time is spent; and when, because of the monotony of the employment, the employer is of necessity directly concerned with the morale and recreation factor, the "scope of employment" is broadened to include recreational activities, including driving for recreation. And this is so as much for an individual employee as it is for several. This holding fits this case to a "T".

The trial court believed that the *Murphey* case was inapplicable and distinguishable. But consider the parallel facts. In the *Murphey* case, the soldier was stationed with about twenty other men at an *isolated encampment* in Northern California. In order to keep up the *morale* of the men the commander provided an army truck for nightly visits to Klamath for "*entertainment, movies, etc.*" On the night in question, the soldier *while on pass* drove some men to town and parked the truck at a designated location. The commanding officer testified that the soldier was not free to use the truck again until such time as the group was ready to return to the encampment. Nevertheless, in violation of the army regulations, the soldier and a buddy *visited a saloon*, picked up two women, and started in the truck toward a nearby Indian ceremonial. During the trip the truck hit a pedestrian and killed her. The trial court found that the soldier was not acting within the scope of his employment

because the vehicle was not to have been moved and was not to have been used for *personal pleasure*. But this Court reversed, holding:

“The government brief concedes that Brander was acting within the scope of his employment in driving himself and other soldiers into the town of Klamath for their recreation, but contends that such recreational employment of the truck by the sergeant alone could not be a military employment. We do not agree. Improvement of morale of a single soldier is as much military in character as of several . . .”

* * *

“We think the overriding purpose in Brander’s employment in the use of the truck in the town of Klamath is the *improvement of the morale* of soldiers in seeking ‘entertainment.’ The ‘movies, etc.’ certainly would include the Indian Ceremonial. The government being liable as a private person in California, it is liable where the truck was in use for the broad purpose for which it was employed by Brander, even though he had instructions that he was not ‘free’ to use it in a particular manner accomplishing that purpose . . .”

* * *

“Here Brander was seeking the specified entertainment which would improve his military morale. That he was ‘directly or indirectly serving his master’ in so doing is none the less within the scope of that employment, because he was serving his own desire and that of the other sergeant *seeking recreation* in taking the latter’s two lady friends to the Ceremonial.” (Emphasis added.)

There is one essential difference between the *Murphey* case, *supra*, and the case at bar, and it is favorable to this appellant. Here Corporal Seabourn not only was authorized to transport personnel to places of recreation; he was authorized to drive the vehicle for his own recreation. Where in the *Murphey* case the latter authority was deemed "incidental" to the former authority, here there is no need to indulge in implication. Our case is therefore stronger.

The *Murphey* case holding, namely, that the pursuit of recreation under similar factual circumstances by an individual soldier is within the scope of his employment because the governmental purpose of improvement of morale is being served, conforms with California law.

For example, consider the numerous workmen's compensation cases dealing with the peculiar factual situation of confinement and morale problems. "Similarly, it is held that employees are in the course of their employment while properly spending their time, when off duty, in a bunkhouse furnished by the employer and in which they are compelled to live." 27 *Cal. Jur.*, 393, Workmen's Compensation, § 90. See also: *Larson v. Industrial Accident Commission*, 193 Cal. 406; *State Compensation Insurance Fund v. I.A.C.*, 194 Cal. 28; *Employer's Liability Assurance Corp. v. I.A.C.*, 37 C.A. 2d 567; *Union Oil Co. v. I.A.C.*, 211 Cal. 398; *Truck Insurance Exchange v. I.A.C.*, 27 Cal. 2d 813; *Pacific Indemnity Co. v. I.A.C.*, 26 Cal. 2d 509; *West v. I.A.C.*, 79 C.A. 2d 711; *Jiminez v. Liberty*

Farms Co., 78 C.A. 2d 458; *Pacific Employer's Ins. Co. v. I.A.C.*, 77 C.A. 424.

Moreover, the pursuit of recreation for the employer's purposes of morale has recently been recognized by the California courts as broadening scope of employment under respondeat superior of employees who unlike soldiers or bunkhouse workers are not even subject to such rigid control and confinement. In *Boynton v. McKales*, 139 C.A. 2d 777, a salesman attended a salesmen's banquet, became intoxicated from liquor provided by the employer, and on the way home struck a pedestrian. He pleaded guilty to a violation of Vehicle Code § 501. The defense was that the occasion was a "social" one. But the Court held (p. 789): "The attendance at a social function, although not forming part of the normal duties of the employee, may come under the 'special errand rule' if the function of the attendance was connected with the employment and for a material part intended to benefit the employer who requested or expected the employee to attend." The Court said, "It is not necessary that the servant is directly engaged in the duties which he was employed to perform, but included are also missions which incidentally or indirectly contribute to the service, incidentally or indirectly benefit the employer." The benefit to the employer found by the Court was that the social occasion contributed to the "continuity of employment." These last words are mere synonyms for "morale."

2. The Fact That Seabourn Drunkenly and Negligently Performed the Authorized Act of Driving for Recreation Does Not Relieve the Government of Liability.

The trial court found that Seabourn was on a frolic, "drinking and running around" (T.R. 11). This finding misses the most important distinction between this case and the "chamber of horrors" exception noted in the *Murphey* case wherein the Court stated, "We are not holding that in any case where a soldier is on a frolic of his own he can make the Government liable simply because he there found entertainment" (T.R. 10). *But in the case at bar the recreational driving was authorized!* Nowhere, presumably, except upon an isolated, overseas post would the practice of issuing vehicles to soldiers for recreational driving exist. But it did here, so should the Government be relieved of liability because the soldier added drinking to his driving? The answer is no. As the Court said in *Christian v. U.S.*, 184 F.2d 523, 525 (6th Cir. 1950):

"It is true that a master would not be exonerated on the theory that his servant was not employed to get drunk and therefore departed from the scope of his employment in doing so. To the contrary, drunkenness on the part of the agent is an act of negligence for which his employer becomes liable, if the servant otherwise is acting within the scope of his employment."

The rule of course is that the doing of an authorized act in a wrongful or prohibited manner will not preclude responsibility of the employer. *Restatement of Agency*, §§230, 229; *Fields v. Sanders*, 29 Cal.

2d 834, 839; *Haworth v. Elliott*, 67 C.A.2d 77, 81; *Hiroshima v. P.G.&E.*, 18 C.A.2d 24.) The correct test to apply to Seabourn's conduct is stated by the California Court:

"The test is not whether the wrongful act itself was authorized but whether it was committed *in the course of a series of acts of the agent which were authorized by the principal* and while the agent was still occupying himself with the principal's business within the scope of his added employment." (Emphasis added.)

Deevy v. Tassi, 21 Cal.2d 109, 125.

B. Even If Seabourn's Authority to Drive Was Limited to Transportation to and From Government-Provided Recreation Facilities, His Acts Were Within His Scope of Employment.

The trial court held that the issue of "frolic and detour" was not presented in this case, because "Seabourn was not in the course of his employment when he left base" (T.R. 13). Appellant contends that this holding again misses another aspect of Seabourn's authority—the authorized use of the vehicle in going to and from the government-provided recreational facility—the NCO Club. This was the purpose testified to by one of Seabourn's companions:

"Q. What was his purpose in using that weapon's carrier, as far as you know?

A. For recreation; he wanted to go to Twentieth Air Force Headquarters, to the NCO Club there" (R. 17).

Considering this to be so, then appellant contends that the *Murphey* case is practically on all-fours

No material distinction exists between that case and the instant case.

The dissenting judge in the *Murphey* case wrote the opinion for this Court upon our prior appeal. He felt that the *Murphey* case involved the question whether the negligent act was committed while engaged in such a deviation from employment, *i.e.*, frolic, as to relieve the government of liability. Appellant contends that, so considered, the *Murphey* case is even stronger authority for her position here, since the Court's distinctions are immaterial. And it should be noted that the trial Court below in its memorandum opinion adopted some of these very same alleged distinctions (T.R. 10). Since the Supreme Court vacated the judgment of this Court on its prior appeal, the adoption by the trial court of these disapproved distinctions should be suspect.

The trial court and this Court sought one distinction in the fact that unlike Seabourn, the driver in the *Murphey* case was acting under "specific authorization of his commanding officer" to take the truck into town "for pleasure under instructions" for "entertainment, movies, etc.", another that the majority of the Court thought that the "official permission" thus granted was broad enough to include a visit to an Indian dance being held a short distance outside of this town and that this was "digression", another that "it was not contended that he was drunk at the time, or that drinking contributed in any way to his negligence", another that the soldier there was seeking "specified entertainment", another that

the soldier's superior officer knew that as incidental acts the truck was employed to reach places of entertainment outside of Klamath.

But in the case at bar there is evidence that the use of army vehicles for "recreation" to go to the NCO Club and elsewhere and back to post had been a long established army practice indulged in by all members of the soldier's post, officers included. It is a certainty from uncontradicted evidence that his superior officers, specifically Lt. Werb, knew of this long established custom. Moreover, the *Murphey* case driver had visited a saloon. For what purpose? Obviously, to drink! Indeed, he had picked up two lady friends as passengers!

The trial court in the *Murphey* case also found that special permission was required to use the vehicle for the pleasure of the men to go to any place other than Klamath, and that the truck driver was not authorized to operate the vehicle for his use or for any other use than that of driving to Klamath and parking the vehicle by the side of a building. Here, likewise, it is claimed that army regulations governing the use of the vehicle were violated.

The similarity between the *Murphey* case and the instant case is startlingly apparent, however, from the court's discussion of the "overriding specific purpose" allegedly present in the *Murphey* case, to-wit, improvement of morale in seeking "entertainment, movies, etc.", even though the truck driver "had instructions that he was not free to use it in a particular manner accomplishing that purpose."

In the case at bar Seabourn was authorized to use the vehicle for "recreation". We find no distinction between "entertainment" and "recreation", or "movies, etc." and "recreation" at an NCO Club. We contend that the issue is clearly presented by the evidence whether Seabourn had departed from and resumed his employment. Furthermore, if the *Murphey* case driver was not on such a departure or frolic as would preclude liability, then neither was Corporal Seabourn.

CONCLUSION.

The California Court has aptly said:

"The employer's responsibility for the tortious conduct of his employee 'extends far beyond his actual possible control over the conduct of the servant. It rests on the broader ground that every man who prefers to manage his affairs through others, remains bound to so manage them that third persons are not injured by any breach of legal duty on the part of such others' while acting in the scope of their employment . . . Such injuries are one of the risks of the enterprise . . ."

Carr v. Wm. C. Crowell Co., 28 Cal. 2d 652.

The Restatement also states:

"Since the phrase 'scope of employment', is used for the purposes of determining the liability of the master for the conduct of servants, the ultimate question is whether or not it is just that the loss resulting from the servant's acts should

be considered as one of the normal risks to be borne by the business in which the servant is employed."

Rest. Agency, §229, Comment a.

In the case at bar appellant was seriously and permanently injured by reason of the drunk driving of Corporal Seabourn. She suffered lacerations (R. 35), fractured transverse processes of three vertebrae (R. 39), scarring and restricted motion of her right leg (R. 35-36), recurring and persistent headaches, pain in the chest, backache and chronic back strain, uncontrollable trembling and shaking of the muscles of her legs' functional involvement, all resulting in a loss of 35% of her ability to do general work (R. 40). These conditions are permanent (R. 39), and involve, and would involve, further surgery and treatment resulting in medical expenses alone well over \$2,000.00 (R. 39).

It is not just or fair that she be forced to bear this loss.

It is respectfully submitted that the judgment for defendant should be reversed and that judgment should be ordered in favor of plaintiff and against defendant for such amount as the trial court on that issue alone should decide is meet and proper.

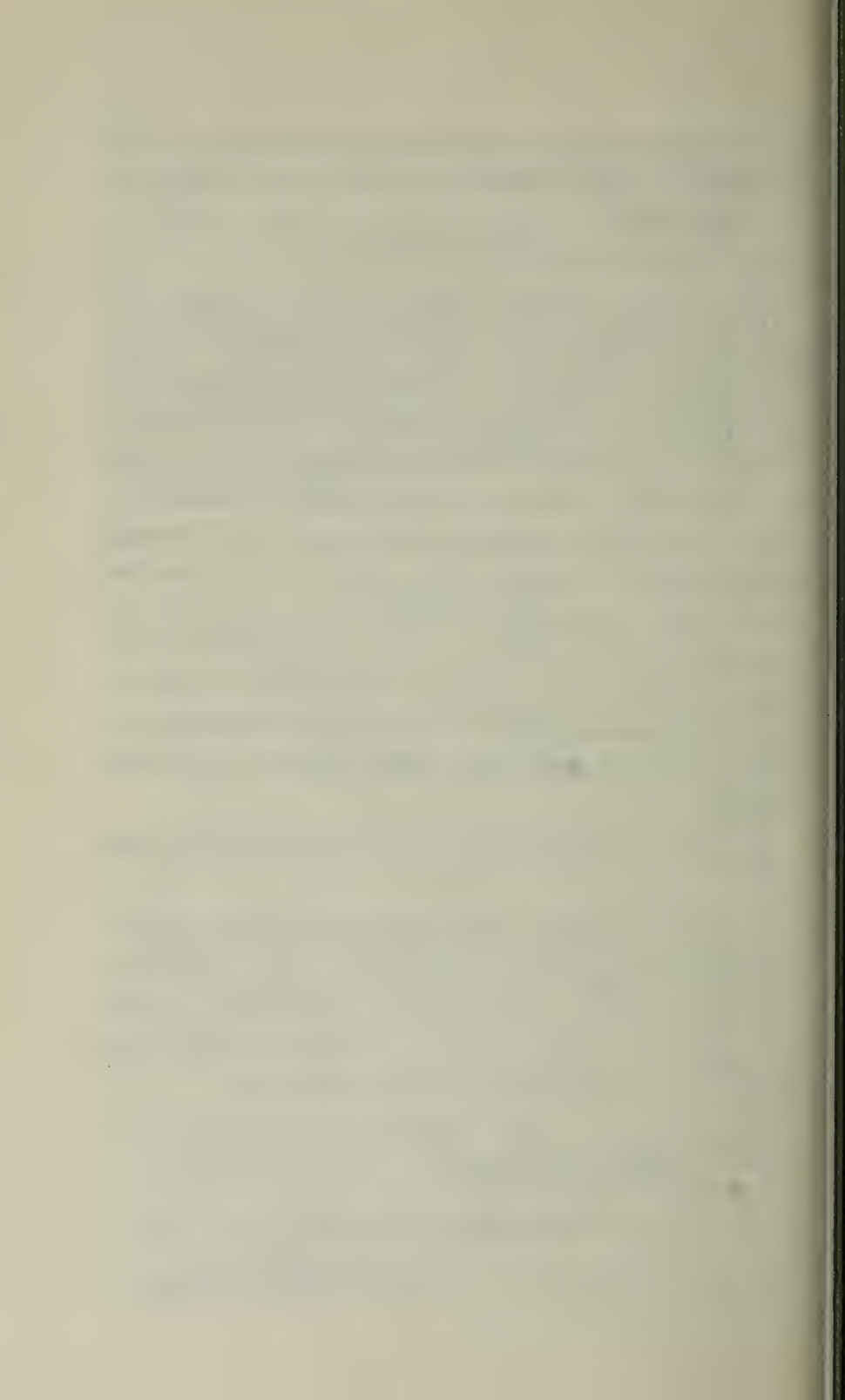
Dated, San Francisco, California,

February 27, 1957.

Respectfully submitted,

HENRY C. CLAUSEN,

Attorney for Appellant.



No. 15,338

In the United States Court of Appeals
for the Ninth Circuit

ALTHEA G. WILLIAMS, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTH-
ERN DIVISION

BRIEF FOR APPELLEE

GEORGE COCHRAN DOUB,
Assistant Attorney General.

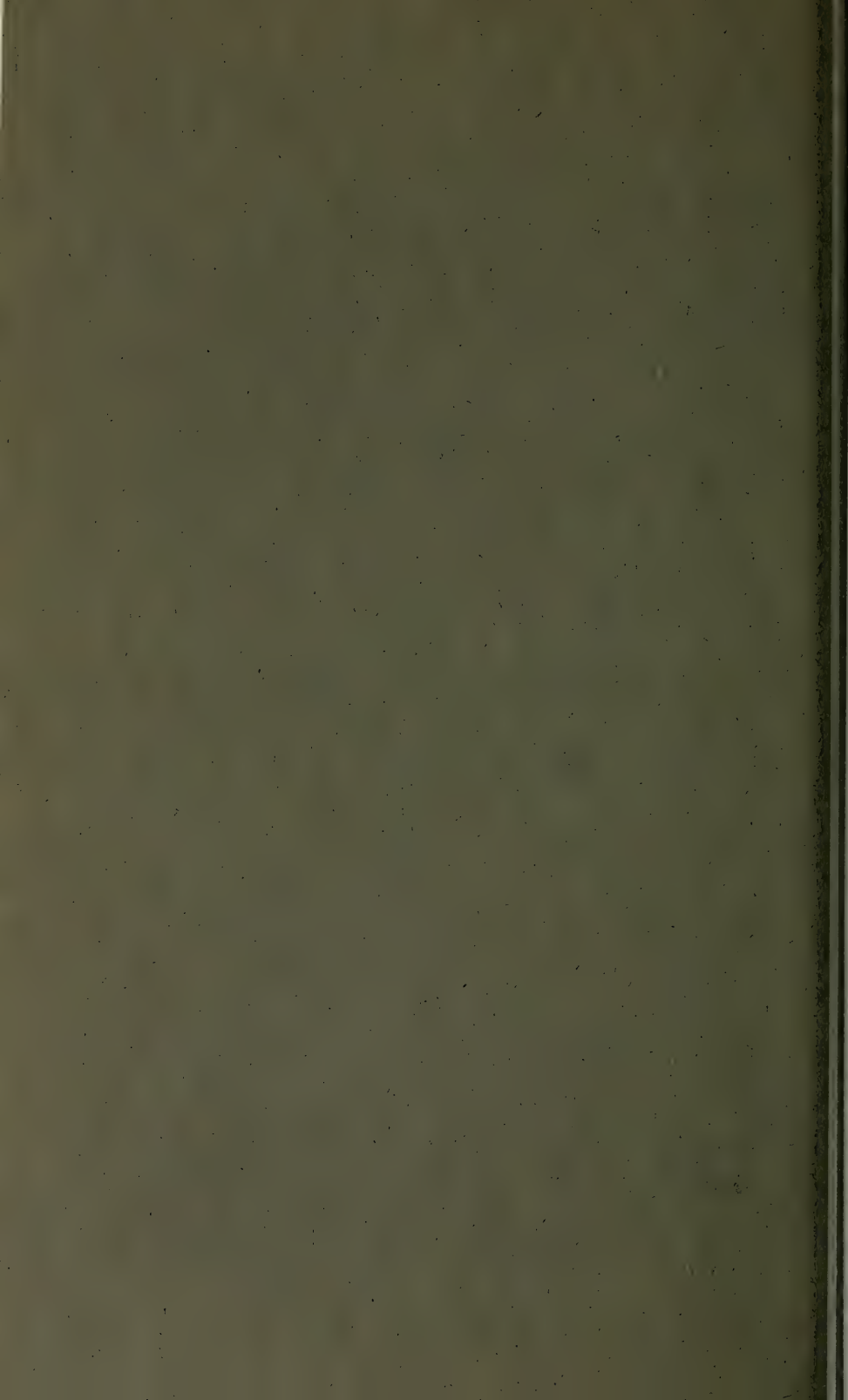
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PAUL P. O'BRIEN, CL



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**In the United States Court of Appeals
for the Ninth Circuit**

No. 15,338

ALTHEA G. WILLIAMS, APPELLANT

v.

UNITED STATES OF AMERICA, APPELLEE

*ON APPEAL FROM THE UNITED STATES DISTRICT COURT
FOR THE NORTHERN DISTRICT OF CALIFORNIA, SOUTH-
ERN DIVISION*

BRIEF FOR APPELLEE

JURISDICTION

This appeal brings this Federal Torts Claims Act suit here for the second time. See 215 F. 2d 800. This Court's jurisdiction rests on 28 U.S.C. 1291. Notice of appeal was filed August 27, 1956, from a judgment in favor of the United States entered on July 12, 1956 (T.R. 16, 17).¹

STATEMENT

Appellant, an employee of a private construction firm in Guam, sustained personal injuries when a

¹ "T.R." refers to the pages of the typewritten record on this appeal; "R." references are to the pages of the record printed for the United States Supreme Court in this case and filed here pursuant to stipulation. See T.R. 23-24.

parked car in which she was sitting was struck by a military vehicle driven by a Cpl. Seabourn (R. 51, 168). The accident occurred in Agana, Guam, at about 10:30 P. M. on March 3, 1949 (R. 51, 168).

The facts concerning Seabourn's use of the vehicle—all of which were “fully established as true” by “credible and competent evidence of a convincing character”—are summarized in this Court's earlier opinion as follows (215 F. 2d 800, 803-804; R. 170-172) :

Seabourn obtained an appropriate pass to leave the army base on and for the day of March 3, 1949. Accompanied by two other soldiers (Schmidt and Vincent) he spent the afternoon drinking beer. The three men returned to the base about 7 p. m. and while there, a Sergeant Stiles, a member of Seabourn's company, gave Seabourn a so-called “trip ticket” for a $3\frac{3}{4}$ ton vehicle known as a “weapons carrier.” This ticket had been made out about 8 a. m. that morning to a driver named Cabera, a soldier who also worked with Seabourn, and it discloses that the vehicle had been requested by a Lt. W. R. Werb, and use of the vehicle was therein authorized for “Official Business.” Listed on the ticket are the various special points to which the weapons carrier was driven that day. Neither Seabourn's nor Stiles' name appears on the ticket, nor was Seabourn's use of the vehicle in any way indicated thereon.

By means of this “ticket,” Seabourn secured possession of the vehicle and in company with the two men named drove to the Enlisted Men's Club on the Island where they drank more beer as well as some champagne, and then they decided to “go

for a ride." Thereafter, and prior to the accident here involved, Seabourn let his companions out of the vehicle and drove off alone. These companions later swore that Seabourn was then "definitely drunk," and Seabourn himself swore that he remembered nothing further until the next morning when he awoke beside a road.

Seabourn's use of the vehicle while thus "off duty" and in quest of entertainment, was not a use in furtherance of any prescribed or indicated military duty. The vehicle was not being used in Seabourn's "off duty" period to serve any prescribed or noted military purpose or interest of the government, nor was Seabourn's use motivated by such a purpose. His superior military authorities had no knowledge of, or supervision over, the use of the vehicle while it was in Seabourn's possession, nor any control over Seabourn after he had secured it from Stiles by using the Cabera ticket which had been previously issued by Lt. Werb * * * . Nor was any military order issued by a superior officer directing or authorizing Seabourn to use the vehicle for *any purpose*, military or otherwise (including "recreation"), or for the execution of any military order.

Notwithstanding the foregoing facts, which this Court's opinion emphasized "are fully reflected in the record before us" (R. 172), appellant's complaint against the United States under the Tort Claims Act asserted that Seabourn's negligent operation of the vehicle was in the line of his duty for the Government (R. 1). These allegations were denied in the Government's answer (R. 6). Upon trial of the case, the Dis-

trict Court for the Northern District of California found that the accident was caused by Seabourn's negligence (R. 51). It further found, however, that Seabourn was off duty and away from his base on a pass when the accident happened; that he had obtained unauthorized possession of the military vehicle; that he was not using it for any purpose authorized by Army Regulations, by his superior officers, or by the trip ticket; that, instead, he was on a frolic of his own, and not acting within the scope of his employment (R. 47, 51-52). Judgment was therefore entered in favor of the Government (R. 52-53).

On appeal, this Court approved the district court's findings. 215 F. 2d 800. In addition, as already noted, this Court reviewed the facts independently and found that "Seabourn's use of the vehicle while * * * 'off duty' and in quest of entertainment, was not a use in furtherance of any prescribed or indicated military duty"; that Seabourn did not use the vehicle to "serve any prescribed or noted military purpose or interest of the government"; that his use of the vehicle was not "motivated by such a purpose"; that his superior officers "had no knowledge of, or supervision over, the use of the vehicle while it was in Seabourn's possession, nor any control over Seabourn after he had secured it from Stiles"; and that no order had been issued by any superior officer "directing or authorizing Seabourn to use the vehicle for *any purpose*, military or otherwise (including 'recreation')" (R. 172).

This Court's opinion further pointed out (215 F. 2d 800, 808-809; R. 180):

Reduced to their simplest terms, the facts of this case show beyond any doubt that Seabourn was out

on a wild frolic when he injured appellant; that he was then drunk and in an irresponsible mood; that he was not then executing any military order or on military business of any kind. And if resort be had to the California cases cited in our Murphey opinion which deal with liability of a private employer (under the *respondeat superior* doctrine), we suggest that it would bankrupt the most exuberant imaginative powers to envision Seabourn's criminal conduct as an activity which a private employer "should reasonably have expected would be done," or that such conduct was "serving his master".

Noting that a private employer would not "be held liable in damages for the tortious act of an employee occurring on an allowed 'day off' while he is out driving on a joy ride while drunk," this Court affirmed the district court judgment, which had exonerated the Government from liability for Seabourn's negligence while "out on a wild frolic" (R. 179, 180, 183).

Appellant thereupon filed a Petition for a Writ of Certiorari in the Supreme Court, stressing the conflict in decisions between the circuits as to whether the "scope of employment" or "*respondeat superior*" question in Federal Tort Claims Act suits was to be decided by reference to Federal law or to the law of the State where the negligent act or omission occurred (Pet. No. 470, Sup. Ct., Oct. T., 1954, pp. 7-13).² The Supreme

² The Fifth Circuit, in *United States v. Campbell*, 172 F. 2d 500, 503 (C.A. 5), certiorari denied, 337 U.S. 957, had viewed State law as controlling. See also *United States v. Eleazer*, 177 F. 2d 914 (C.A. 4), certiorari denied, 339 U.S. 903. This Court, on the other hand, had held in its opinion in this *Williams* case that Federal

Court granted the petition and resolved the conflict by holding that local law controlled. The Supreme Court accordingly declared (350 U.S. 857):

The case is controlled by the California³ doctrine of respondeat superior. The judgment [of the Court of Appeals] is vacated and the case is remanded [to the District Court] for consideration in light of that governing principle.

On remand, the district court recognized that "the only question now before the court is whether the facts of this case, when considered under applicable California law, will support plaintiff's contention that Seabourn was acting within the scope of his employment at the time of the collision" (T.R. 5). After a careful and detailed review of the California cases (T.R. 6-13), the district court ruled that (T.R. 13):

* **Seabourn's conduct on the entire day of the collision cannot be construed under California law to have been within the scope of his employment. At the time of the accident he was on his day off—subject to his own whims, desires and devices. The evidence is devoid of any showing that Seabourn, at any time during the course of his day off interspersed his employer's work with his own personal and unrelated activities. In the absence of these

law was determinative, at least where the plaintiff had been injured by a Federal military employee rather than by a civilian. 215 F. 2d 800, 807; R. 178-179. This accorded with the Fourth Circuit's view at that time. *United States v. Sharpe*, 189 F. 2d 239, 241.

³ Guam has adopted, as this Court has already noted in this case, "the rule of respondeat superior in force in California. It is thus 'the law of the place,' i.e., Guam." 215 F. 2d 800, 802; R. 170. See also *United States v. Johnson*, 181 F. 2d 577, 580-581 (C.A. 9).

factors the court finds that the facts in this case do not meet the test of the *respondeat superior* doctrine as enunciated by the California cases so as to impose financial responsibility on the United States.

In view of this ruling and on the basis of the earlier findings of fact entered by the district court at the time of its first judgment in the case—all of which findings were expressly “remade and reinstated”—the court again directed the dismissal of the complaint and the entry of judgment in favor of the United States (T.R. 16, 17).

QUESTION PRESENTED

Whether the trial court, in light of the applicable California rule of *respondeat superior*, correctly held that the Federal Government was not liable for injuries caused by a serviceman who, while off duty and on pass, obtained unauthorized possession of a military vehicle and went joy riding in it.

STATUTE AND REGULATIONS INVOLVED

The relevant provisions of the Federal Tort Claims Act and the Army Regulations are set forth in the Appendix, pp. 18-20.

SUMMARY OF ARGUMENT

The question now here for decision is a narrow one—*i.e.*, whether, under California law, Seabourn was acting at the time of the accident within the scope of his employment for the United States. Our discussion below shows first that California, like other jurisdictions, imposes *respondeat superior* liability only where the employee is engaged in the furtherance of his employer's

business at the time of the tort. We then show that the facts here undeniably establish that the course of conduct embarked upon by Seabourn was the very antithesis of that encompassed by his course of employment. At the time of the accident, Seabourn was in the quest of personal entertainment. And, as this Court has already stated in reviewing the facts here involved, he was not at that time furthering or serving any "prescribed or noted military purpose or [other] interest of the government" (215 F. 2d 800, 804; R. 172). It follows, we submit, that the district court was plainly correct in refusing to impose any vicarious liability on the United States for Seabourn's tort.

ARGUMENT

Under California Law, Seabourn Was Not Acting Within the Scope of His Employment

A. The California Rule of Respondeat Superior Imposes Liability Only Where the Employee Was on His Employer's Business at the time of the Tort

There is a basic and universally accepted pre-condition for application of the *respondeat superior* doctrine in order to hold an employer vicariously liable for his servant's tort. It is that the servant, at the time of the accident, must be "conducting the master's affairs * * *". The master's responsibility cannot be extended beyond the limits of the master's work." The *Standard Oil Co. v. Anderson*, 212 U.S. 215, 221; *Balinovic v. Evening Star Newspaper Co.*, 113 F. 2d 505, 506 (C.A. D.C.); *Farwell v. Boston and Worcester Railroad Corporation*, 4 Metcalf 49, 55-56. The "ground of liability

of the master for the negligent act of the servant is that the servant is conducting the master's affairs." *United States v. Eleazer*, 177 F. 2d 914, 916 (C.A. 4), certiorari denied, 339 U.S. 903. The "dominant purpose," as stated by Cardozo, J., "must be proved to be the performance of the master's business." *Fiocco v. Carver*, 234 N.Y. 219, 223, 137 N.E. 309. Obviously, if the employee is not prosecuting or furthering his employer's business, "his acts cannot, upon the doctrine of respondeat superior, be imputed to the employer. * * * No jurisprudence with which we are familiar holds to the contrary or states the principle differently." *Johnson v. Esso Standard Oil Co.*, 211 F. 2d 397, 399, 400 (C.A. 5).

California, of course, follows the same rule. It recognizes that the touchstone for *respondeat superior* liability is the servant's furtherance of his master's business at the time of the accident. The California cases accordingly hold that an employee's negligence will not be imputed to his master if the negligence occurs when the servant uses his master's vehicle not for the purpose of performing any employment duties assigned to him, but after hours while he is off duty and on a personal mission.

Three of the leading California cases, discussed in the opinion below, are close on their facts to the present case. (T.R. 6-9). These cases underscore the full recognition by California courts of the principles (1) that the master-servant relationship itself is not a sufficient basis on which to predicate a *respondeat superior* liability and (2) that there can be no such liability where, at the time of the accident, the employee is engaged on his own and not on his employer's business. Thus, in *Kish*

v. *California State Automobile Assn.*, 190 Cal. 246, 248, 212 Pac. 27, the California Supreme Court refused to impose a *respondeat superior* liability where the employee at the time of the accident was not in performance of any act connected with the business of his employer but had finished his work for the day and was off duty and on his way downtown for supper. Again, *Lee v. Nathan*, 67 Cal. App. 111, 226 Pac. 970, held that there could be no *respondeat superior* liability where the employee was driving the employer's vehicle after duty hours while pursuing his own ends despite the fact that the injuries to the plaintiff could not have been committed without the facilities so afforded to the employee by the employer. And in *Slater v. Friedman*, 62 Cal. App. 668, 672, 217 Pac. 975, the court reiterated the rule that where the servant's "act is done while the servant is at liberty from service and pursuing his own ends exclusively, there can be no question of the master's freedom from all responsibility, even though the injury complained of could not have been committed without the facilities afforded to the servant by his relation to the master."⁴

This Court's decision four months ago in *Pacific Freight Lines v. United States*, 239 F. 2d 191, furnishes still more recent authority for the view that California law does not impose a *respondeat superior* liability unless at the time of the accident the employee was actively engaged in furthering his employer's business rather than his own personal interests. *Pacific Freight*, just as the case now here, was a Federal Tort Claims

⁴ It is significant that these three California cases, relied upon by the trial court and discussed at length in his oral opinion (T.R. 6-9) are not distinguished, discussed, or even cited in appellant's brief.

Act suit arising out of an accident involving a military vehicle driven by a serviceman. In addition, like the present case, the principal question in *Pacific Freight* was whether the serviceman was acting within the scope of his employment under California law. 239 F. 2d 191, 193. After reviewing the pertinent California cases, this Court in *Pacific Freight* exonerated the Government from liability, holding that the serviceman was not acting within the scope of his employment under California law at the precise time of the accident because he was not then performing service for the Government. 239 F. 2d 191, 195.

We submit that the identical conclusion is called for here. Seabourn, as the record shows, was not on Government business at the time of the accident. Seabourn's regular duty was that of supply clerk (R. 13). On the day of the accident, March 3, 1949, he was on pass, "did not work at all," and "just took off" (R. 14, 24). His taking and use of the Government vehicle was not even remotely connected with his duties as a supply clerk or with any other "official duties" (R. 17, 26). Instead, he took possession of and used the vehicle to indulge in joy riding and in drinking. As noted by the court below (T.R. 13), Seabourn "was on his day off—subject to his own whims, desires and devices. The evidence is devoid of any showing that Seabourn, at any time during the course of his day off interspersed his employer's work with his own personal and unrelated activities."

When this case was first here, this Court, after discussing the foregoing facts, flatly pointed out that under California law Seabourn's conduct could not possibly be viewed as being within the scope of his employment (215 F. 2d 800, 808-809; R. 180):

Reduced to their simplest terms, the facts of this case show beyond any doubt that Seabourn was out on a wild frolic when he injured appellant; that he was then drunk and in an irresponsible mood; that he was not then executing any military order or on military business of any kind. *And if resort be had to the California cases cited in our Murphey opinion which deal with the liability of a private employer (under the respondeat superior doctrine), we suggest that it would bankrupt the most exuberant imaginative powers to envision Seabourn's criminal conduct as an activity which a private employer "should reasonably have expected would be done," or that such conduct was "serving his master."* (Emphasis supplied.)

There has been, of course, no change in the California law of "scope of employment" since the date of this Court's earlier opinion in this case.⁵ Seabourne's conduct, we respectfully submit, must therefore—in the course of this Court's present reconsideration of this case—still be viewed as not being within the scope of his employment under California law.⁶

⁵ While the judgment of this Court, implementing its earlier opinion, was vacated by the Supreme Court, 350 U.S. 857, nothing the Supreme Court said in any way detracts from the validity of that part of this Court's earlier opinion based on the California law of scope of employment. To the contrary, the whole purpose underlying the Supreme Court's review and holding in this case was to insure application of such California law. 350 U.S. 857. See fn. 2, p. 5.

⁶ It is also important to note that the Government's lack of control over Seabourn in the performance of the negligent act which caused the injury constitutes an additional and independent reason precluding *respondeat superior* liability here. It cannot be challenged that Seabourn, at the time of the accident, was on pass and free of any military duty (R. 17, 26, 51, 170, 179). His relation-

B. *The "Recreational Activity" Label, Placed by Appellant on Seabourn's Unauthorized Use of the Military Vehicle for Drinking and Joy Riding, Does Not Bring It within the Scope of His Employment*

We fully recognize that the armed services, like many other employers—are directly concerned with the morale and recreation of servicemen. A sound recreational program improves employees' morale and efficiency, enables them to maintain work at a high level, and thus indirectly benefits the employer's business.⁷

ship to the Government while on this pass or off-duty status "was not analogous to that of a soldier * * * performing duties under orders." *Feres v. United States*, 340 U.S. 135, 146. A soldier who is off duty or on pass is not engaged in the business of the United States. While on pass or leave, a serviceman "is at liberty to go where he will during the permitted absence, to employ his time as he pleases, and to surrender his leave if he chooses." *United States v. Williamson*, 23 Wall. 411, 415. The leave is a favor extended "for his sole accommodation" to permit him to "enjoy a respite from military duty." *Foster v. United States*, 43 C.Cls. 170, 175; see *Hunt v. United States*, 38 C.Cls. 704, 710.

⁷The decided cases, however, take the view that the benefits inuring to the employer through improved employee morale are too indirect and intangible to justify imposition of *respondeat superior* liability. Thus, the courts have noted that increased employee morale and loyalty does not warrant the conclusion that "the servant taking advantage of this permission [to use employer's car] is in a legal sense promoting or facilitating the master's business." *Adams v. Quality Service Laundry & Dry Cleaners*, 253 Wis. 334, 337, 34 N.W. 2d 148; *Gewanski v. Ellsworth*, 166 Wis. 250, 253, 164 N.W. 996. See also *Rogers v. A.-C. Mfg. Co.*, 153 Ohio St. 513, 92 N.E. 2d 677 (employer not liable for tort of employee playing on employer's team in industrial golf league); *Toms v. Delta Savings & Loan Ass'n*, 162 Ohio St. 513, 124 N.E. 2d 123 (employer not liable for tort of baseball player where employer furnished team with uniforms and equipment); *Stenzler v. Standard Gas Light Co. of N. Y. City*, 179 App. Div. 774, affirmed, 226 N.Y. 681, 123 N.E. 891 (employer not liable for injuries resulting from collision with its truck which was lent to employees for use on a picnic); *Har-rington v. Border City Manuf. Co.*, 240 Mass. 170, 132 N.E. 721

And we also recognize that there may be even greater need for employer-organized and employer-supervised recreational activities where employees are based on an island, like Guam, thousands of miles removed from the homeland.

The pertinent Army Regulations, No. 700-105 (*infra*, pp. 19-20), do allow the use of Army vehicles, whenever possible, for "authorized, organized, and supervised recreational" activities. When the vehicles are so used, the driver assigned to drive the vehicle acts within the scope of his employment because he has been authorized to drive it and because employer-controlled and employer-supervised recreation may be viewed as furthering the employer's business. In our view, *Murphey v. United States*, 179 F. 2d 743 (C.A. 9), which is so heavily relied upon by appellant, holds nothing more than that the driver of an Army truck, acting pursuant to orders in carrying an organized group of soldiers into town for a specified recreational activity, is within the scope of his employment even though the accident happened about two or three blocks off his prescribed route. See the discussion of the *Murphey* case in this Court's earlier opinion, 215 F. 2d 800, 805-806; R. 174-5.

In the present case, it is plain that Seabourn was not using the vehicle to transport military personnel in connection with an organized and authorized activity. Instead, his taking and use of the vehicle was "unau-

(employer not liable for injuries resulting from baseball game played by employees during lunch hour on employer's premises); *Beatty, Appellant v. Firestone T. & R. Co.*, 263 Pa. St. 271, 106 Atl. 303; *Reilly v. Connable*, 214 N.Y. 586, 108 N.E. 853; *Stenger v. Mitchell*, 70 Ga. App. 563, 28 S.E. 2d 885; *Loucks v. R. J. Reynolds Tobacco Co.*, 188 Minn. 182, 246 N.W. 893.

thorized," "without the knowledge or approval" of his superior officers, and in contravention of applicable Army Regulations (R. 47, 180). When the accident happened, Seabourn, whose entire trip was unauthorized, had not merely deviated from a prescribed, official route, as had the soldier in the *Murphey* case. Seabourn's "wild, reckless and wholly independent act of violence" while joy riding and drunk was, as this Court observed, "a far cry" from any recreational activity authorized in the Army Regulations (R. 180; see also T.R. 11). Moreover, the theory that a recreational activity subjects an employer to a *respondeat superior* liability is the assumption, noted above, that the activity will improve the employee's efficiency and increase his work output, with the resulting benefit to the employer.⁸ Obviously, Seabourn's conduct, far from being calculated to improve his efficiency was much more likely to result in a serious accident with disabling injuries which would impair, if not completely destroy, his work efficiency.

Throughout her brief appellant (1) assumes that the record requires a finding of a custom or practice in Seabourn's unit to use military vehicles, issued to others for official use, for individual recreational purposes, and (2) urges that this "custom" or "practice", although in plain contravention of the regulations, is enough to demonstrate that Seabourn was acting within the scope of his employment. While there may be slight evidence of such a custom in the record, it is highly significant that due to the apparent meagerness of such evidence, neither the trial court nor this Court accepted appellant's proposed factual finding that Seabourn's

⁸ Cf. cases cited *supra*, fn. 7, pp. 13-14.

use of the vehicle "was in accordance" with such an "established custom" (R. 45, 49, 55, 180). In addition, both courts found that no responsible official authorized Seabourn's use of the vehicle (R. 47, 172, 180), and this Court's earlier opinion indicated that, if the claimed practice existed, no proper officer countenanced or knew about it (215 F. 2d 800, 808; R. 180).

In any event, even if it is assumed that in Seabourn's particular unit military vehicles were passed on from one serviceman to another and surreptitiously used, despite the trip ticket, for off-the-post individual recreation, that casual and illegal practice cannot transform Seabourn's drunken frolic into a recreational activity within the scope of his employment. In the first place, such a drunken frolic obviously serves no governmental purpose or interest and hence cannot be viewed as coming within the employee's "scope of employment" under California law. See pages 8-12. Secondly, as we have pointed out (p. 15), "recreation" of this character can hardly be termed an aid to the maintenance or improvement of the efficiency of the troops. And finally, the pertinent Army Regulations forbade any practice of passing vehicles around and using them as Seabourn did here (p. 14), and his driving was therefore clearly unauthorized.

We do not mean to argue that no serviceman whose activity is in violation of a regulation can ever be held to be acting within the scope of his employment. Perhaps if the whole action is plainly for the benefit of the service, an incidental violation in means or method can be ignored. But certainly where, as here, the regulations reveal that a particular activity is definitely not beneficial to the service and is not to be undertaken, a

court would not be justified in holding the serviceman to be within his employment while carrying on that precise activity simply because there had grown up in his company a practice of violating and ignoring the regulation for personal ends.

CONCLUSION

For the reasons stated it is respectfully requested that the judgment of the district court be ~~reversed~~ affirmed

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Assistant Attorney General.

LLOYD H. BURKE,
United States Attorney.

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APPENDIX

A. Sections 1346(b), 2674, and 2671 of Title 28 U.S.C. (the reenactment of the Federal Tort Claims Act, 62 Stat. 933, 982, 983), provide in pertinent part:

SECTION 1346. *United States as defendant.*

* * * * *

(b) Subject to the provisions of chapter 171 of this title, the district courts * * * shall have exclusive jurisdiction of civil actions on claims against the United States, for money damages, accruing on and after January 1, 1945, for injury or loss of property, or personal injury or death caused by the negligent or wrongful act or omission of any employee of the Government while acting within the scope of his office or employment, under circumstances where the United States, if a private person, would be liable to the claimant in accordance with the law of the place where the act or omission occurred

* * * * *

SECTION 2674. *Liability of United States.*

The United States shall be liable, respecting the provisions of this title relating to tort claims, in the same manner and to the same extent as a private individual under like circumstances, but shall not be liable for interest prior to judgment or for punitive damages.

* * * * *

SECTION 2671. *Definitions.*

As used in this chapter and sections 1346(b) and 2401(b) of this title, the term—

* * * * *

“Employee of the government” includes officers or employees of any federal agency, members of the military or naval forces of the United States, and persons acting on behalf of a federal agency in an official capacity, temporarily or permanently in the service of the United States, whether with or without compensation.

“Acting within the scope of his office or employment,” in the case of a member of the military or naval forces of the United States, means acting in line of duty.

B. Army Regulations 700-105 (30 June 1948) provide in pertinent part:

26. *Use of vehicles.*—* * *

b. Motor vehicles * * * will be operated * * * only if properly dispatched on WD Form 48 (Drivers' Trip Ticket and Preventive Maintenance Service Record), issued by the dispatching motor pool or under such instructions as the appropriate commander under existing authority may direct.

c. Motor vehicles will be used only for official business, including the special uses listed in paragraph 28.

* * * * *

28. *Special uses.*—Motor vehicles, when available without detriment to other official business * * * may be used by special direction of the commanding officer for the following purposes:

a. Authorized athletics.

b. Transporting personnel, including entertainers and party guests, and supplies and equipment in connection with authorized, organized, and

supervised recreational, welfare, and morale-building activities.

* * * * *

29. *Motor pools.*—* * *

d. Vehicles will be dispatched from pools to perform specific tasks, and will not be permanently allocated or assigned to any agency or individual, except as prescribed herein.

No. 15,338

IN THE

United States Court of Appeals
For the Ninth Circuit

ALTHEA G. WILLIAMS,

VS.

UNITED STATES OF AMERICA,

Appellant,

Appellee.

APPELLANT'S REPLY BRIEF.

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No. 15,338

IN THE

**United States Court of Appeals
For the Ninth Circuit**

ALTHEA G. WILLIAMS,

Appellant,

VS.

UNITED STATES OF AMERICA,

Appellee.

APPELLANT'S REPLY BRIEF.

**COMMENT ON APPELLEE'S STATEMENT
OF THE CASE.**

Before commencing her rebuttal of appellee's brief, appellant feels impelled to complain vigorously concerning its "factual" content.

In its statement of the case, appellee quotes portions of an opinion of this Court, since disapproved by the U. S. Supreme Court and asks this Court quite unfairly to itself, to re-adopt its own disapproved language as the facts of this case!

Appellee's statement of the facts is merely its factual conclusions flowing from a legal theory since rejected by the Supreme Court.

The former opinion of this Court held erroneously that federal law and regulations (whether enforced or

not) determined the government's liability. This Court was in error when it then said:

"The novel *status* of a soldier arising from this peculiar relationship with his government, was clearly pointed up by emphatic language of the court in *United States v. Standard Oil Co. of California*, 332 U. S. 301, 305, 306, 309, 310. That decision merely brought into sharp focus the controlling legal and constitutional factors underlying such a unique relationship. . . ." (R. 177).

(The said case held that this status was "derived from federal sources and governed by federal authority.") Continuing:

"Congress did not lose sight of this obvious fact while considering the many problems wrapped up in the national defense program in connection with its surrender of immunity to suit under the Act. As we point out herein, one important problem was met and disposed of by a specific provision in the Act which carefully delimited the area of federal liability for a tortious act of (as here) a soldier, by providing that such liability would attach only when the act was committed while the soldier was 'acting in line of [military] duty.' This careful delineation provides a clear line of demarcation between Government liability for a soldier's torts and the area of general liability of a private employer for torts of his employees in classical 'master and servant' cases where the rule of respondeat superior is normally applied. . . ." (R. 177-178).

". . . we must (as we do in this case) hold that 'acting in line of duty' means *acting in line of military duty*. If Seabourn was not acting in line

of *military duty* at the time he injured appellant, the rule of respondeat superior (as applied in orthodox 'master and servant' cases) loses its standardized force for that rule has been modified in the significant manner here noted." (R. 179).

By thus holding that the government could be liable under "federal law" only if Seabourn were performing some "duty" military in character, this Court made it unnecessary to state much of appellant's evidence in its opinion nor to consider its effect under respondeat superior. But the Supreme Court, by rejecting this theory and ordering the case to be reconsidered under principles of respondeat superior, clearly makes such evidence factually relevant to a proper determination of the case. That evidence, erroneously ignored in this Court's former statement of the facts, becomes all-important. It is therefore necessary now to consider its probative effect.

ARGUMENT.

- I. THE EVIDENCE OF CUSTOM AND PRACTICE ON GUAM IS NOT, AS RESPONDENT CONTENDS, "MEAGER". RATHER, IT IS SUBSTANTIAL AND UNCONTRADICTED, AND IT PROVES (1) SEABOURN'S AUTHORITY TO OBTAIN POSSESSION OF THE VEHICLE FOR HIS INDIVIDUAL RECREATIONAL USE, AND (2) A WAIVER OR REPEAL OF ANY PROHIBITORY ARMY REGULATION.

Appellee contends that no "proper" officer authorized Seabourn's use of the vehicle, that "the pertinent Army Regulations forbade any practice of passing vehicles around and using them as Seabourn did here.

... , and his driving was therefore clearly unauthorized.” (A.B. 16).*

In considering these contentions, the court should not lose sight of the fact that the evidence, by mandate of the Supreme Court, is to be considered in the light of the principle of *respondeat superior*, not some other theory based on federal law. Nor should the court lose sight of the fact that the only opinion of this Court which has dealt with a similar case and has withstood the scrutiny of the U. S. Supreme Court is *Murphey v. U. S.*, 179 Fed. 2d 743.

So, therefore, wherein is appellant's evidence on custom and practice “meager”? The evidence, quoted at length in the opening brief, pages 11 to 15, given by three witnesses, without contradiction, certainly qualifies as substantial evidence. It is axiomatic that the testimony of even one witness who is entitled to credit may be sufficient in a civil case to prove a fact, even if it is uncorroborated and contradicted. *Holder v. Key System*, 88 C.A. 2d 925. *Here, appellant's evidence is not even contradicted.* How much more testimony should appellant have produced from 6,000 miles away?

Appellee, however, contends that this Court and the court below found that no “responsible” official authorized Seabourn's use of the vehicle, referring again to the opinions of this Court and the District Court which were disapproved by the Supreme Court. (A.B. 16). As before noted, these opinions were based upon

*A.B. refers to appellee's brief.

an erroneous legal theory which necessarily caused this Court and the District Court to ignore appellant's evidence of custom and practice. Appellee's contention thus begs the question. The question now is whether such evidence proves that Seabourn's use was authorized by a responsible official. Appellant contends that it quite clearly does.

Appellant's evidence showed that the custom, practice and standard operating procedure had existed in Seabourn's Detachment for at least a year and three months before the accident. (R. 11). Appellant's evidence also showed that Seabourn's own commanding officer himself used this procedure. (R. 32). Thus appellee's assertion that no "proper" officer countenanced or knew about this practice (A.B. 16) is completely contrary to the evidence. Recall that although appellee was apprised (by way of pre-trial interrogatories) of appellant's claim that Lt. Werb knew of and authorized the custom and practice *there is no contra evidence. There is no evidence in the record, no testimony of Lt. Werb or his superiors, that the custom and practice did not prevail nor that Lt. Werb did not approve nor himself indulge therein.* The inference of knowledge and authorization is therefore inescapable.

"... knowledge need not be directly proved. It, like any other fact, may be inferred from circumstantial evidence." *Gantner & Mattern Co. v. Hawkins*, 89 C. A. 2d 783, 786. "If it appears that the party has knowledge or information of such facts as are sufficient to put a prudent man upon inquiry and . . . he wholly neglects to make any

inquiry, or, having begun it, fails to prosecute it in a reasonable manner, then also, the inference of actual notice is necessary and absolute." *Hawke v. California Realty Etc. Co.* 28 C.A. 377, 382.

And, who would have been the "proper" or "responsible" officer, other than Seabourn's commanding officer, Lt. Werb, to have authorized the custom and practice? Appellee names none, and certainly appellant, the injured third person, was not bound to search blindly through an elusive, distant and ever changing chain of command to fix responsibility. Her rights shouldn't be lost in the shuffle of "passing the buck."

As said heretofore, appellee again refers to alleged violations of Army Regulations, and, as a non sequitur, concludes therefrom that Seabourn's possession of the vehicle was "clearly unauthorized." Appellee thus again neglects to consider the long-established custom and practice in disregard of such regulations. This case is like those where the servant disregards ignored and unenforced company rules and, under respondeat superior, the employers have been held liable. As the court said in *Fry v. Southern Public Utilities Co.*, 111 S. E. 354, 358 (183 N. C. 281):

"It has been held generally that if a rule is made for the safety of the servant or others, but its *customary violation* has continued so long that the master either knew of it, or could by the exercise of ordinary care have found it out, and acquiesced in it, *he is presumed to have consented to its repeal, or to have waived obedience to it.*" (Emphasis supplied.)

Appellee cites no authority contrary to this rule. Nor could it, since California law is in accord. Negatively speaking, it is true in California that the violation of a company rule does not preclude responsibility of the employer. *Field v. Sanders*, 29 Cal. 2d 834, 839. And, positively speaking, it is true, as this very Court held in *Murphey v. U. S.* supra, while applying California law, that where permission has been granted as a general custom to use an army vehicle for recreation, such practice fixes liability upon the government and renders groundless the trial court's findings that the soldier was not acting within the scope of his employment, even though in a particular case there is positive testimony of prohibitive orders.

In any event, it is odd indeed to find appellee continuing to argue that the alleged violation of an Army regulation, unless it were "incidental in means and methods" (A.B. 16), should relieve the government of liability. The U. S. Supreme Court mandate in this very case is directly to the contrary. The rights of injured third persons are to be governed by the principles of *respondeat superior*, not by the skill of some legal draftsman in the Pentagon, who might, by legal fiction and blind to actualities, so draft or construe administrative regulations as to defeat tort claims by injured third persons. Where authority to do an act is, *in fact, granted*, this Court has held in the *Murphey* case, and the Supreme Court has gone along with the California doctrine that the government thereby becomes liable.

II. MODERN CALIFORNIA LAW IMPOSES LIABILITY ON THE EMPLOYER UNDER THE FACTS OF THIS CASE.

With the exception of a completely distinguishable case, *Pacific Freight Lines v. U. S.*, 239 F. 2d 191, the most recent California authority cited by appellee dates from 1924—thirty-three years ago. No mention is made by appellee of cases like *Boynton v. McKales*, 139 C.A. 2d 777, cited by appellant, and dating from one year ago. Concepts change, and it is no longer true, as appellee contends (A.B. 8-9), that the employee at the time of the accident in order to impose liability must be engaged in “work” or in performance of “duties.” It does not matter that Seabourn was not performing his duty as supply clerk or performing any other so-called “official duties.” (A.B. 11.) Neither the soldier in *Murphey v. U.S.*, 179 Fed. 2d 743, nor the salesman in the *Boynton* case, *supra*, were performing “duties” nor conducting business at the time of their respective accidents.

The important fact which distinguishes the *Pacific Freight* case and the California cases cited by appellee is that in the case at bar, as in the *Murphey* and *Boynton* cases, the employee was authorized *for the benefit of the employer* to engage in recreational activities. Deviations in route, as in the *Pacific Freight* case, are not important. Here the scope of employment, by virtue of the authorization to use the vehicle for recreation, becomes broadened so as to include acts done pursuant to such authorization. The *Murphey* case, decided by this very Court, so holds. The *Boynton* case, decided by the California Court, holds even

more strongly. There the employee was not even expressly authorized to drive his own car from the party, yet the employer was held liable.

To condemn Seabourn's actions as a "drunken frolic" does not answer the question whether his acts were within the *scope* of his employment. The salesman in the *Boynton* case pleaded guilty to drunken driving. The soldier in the *Murphey* case had visited a saloon. Appellant does not contend, nor need she, as the court thought when it said in its former opinion, "that Seabourn was actually indulging in an authorized and permissible form of 'recreation' at the time he crashed his Army vehicle into appellant's car." (R. 179-180). Neither did the appellant in the *Murphey* case have to contend that the soldier was actually authorized to visit the bar, pick up his girl friends, and drive to the Indian Ceremonial. Neither did the respondent in the *Boynton* case have to contend that the salesman was actually authorized to become drunk and drive upon the California highways. Yet in each such case, the wrongful act was performed within the *scope* of employment so far as injured third persons were concerned. The wrongful acts were performed within the course of a series of acts of the agent which were authorized by the principal; and thus each met the test under respondeat superior. *Deevy v. Tassi*, 21 Cal. 2d 109, 125. In the case at bar and in the *Boynton* case, the "drunkenness on the part of the agent is an act of negligence for which his employer becomes liable," *Christian v. U. S.*, 184 F. 2d 523, 525 (6th Cir. 1950). It doesn't relieve of liability—it creates it!

Murphey v. U.S., 179 Fed. 2d 743, is dispositive of this case. It is the law of this circuit. It has been approved by the Supreme Court by virtue of its mandate in our case. The crucial holding is that the recreation and morale of a single soldier is government business, and that the scope of the single soldier's employment broadens to include recreational driving of Army vehicles, where such is authorized, as here, by issuance of a pass (Cf. Appellee's Brief FN 6) and checking out of the vehicle from the motor pool for that purpose. It certainly cannot be emaciated, as appellee would wish (A.B. 14), to become a case where the individual was under *orders* to transport organized groups of soldiers.

The *Murphey* case, along with the *Boynton* case, is directly contrary to the holdings of the foreign cases cited in appellee's brief FN 7. Both the *Murphey* and *Boynton* cases state the *Califorina* doctrine of respondeat superior which the Supreme Court directed must be followed in this case.

This Court need apply only its own decision in the *Murphey* case to satisfy not only the rule of *stare decisis* but indeed the order of the highest Court of the land, and thus most important of all, accomplish justice and give to this permanently injured plaintiff her due.

CONCLUSION.

Appellant respectfully submits that appellee has not met the issues presented in her opening brief. Rather, appellee has presented arguments which, because of their reliance on a disapproved opinion of this Court, necessarily become obsolete following the mandate of the Supreme Court. For all the reasons foregoing, therefore, appellant respectfully requests reversal of the judgment and remand on the issues of damages alone, with costs to appellant in any event.

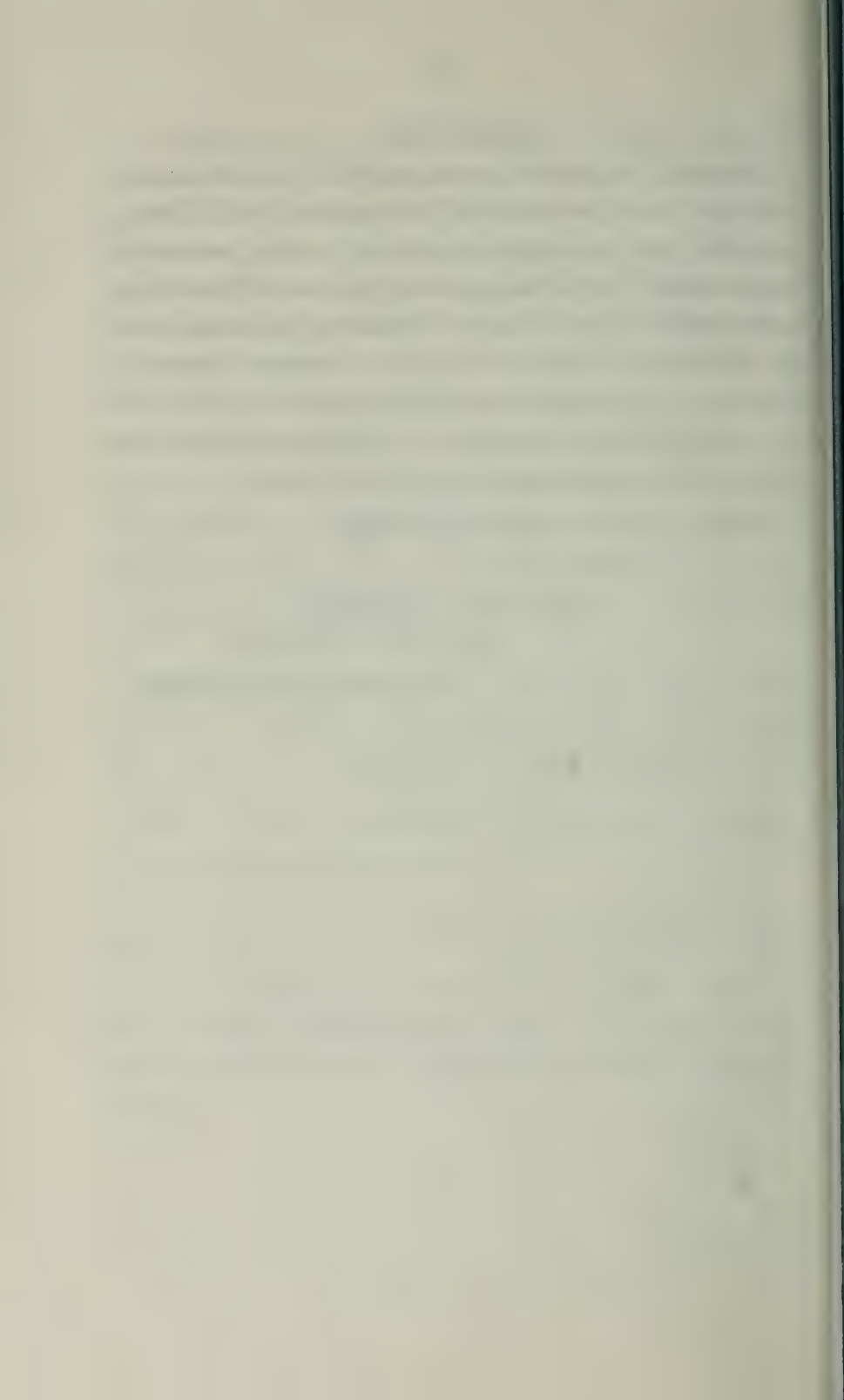
Dated, San Francisco, California,

May 2, 1957.

Respectfully submitted,

HENRY C. CLAUSEN,

Attorney for Appellant.



No. 15340

United States
Court of Appeals
for the Ninth Circuit

ELGIN R. PARKER and FLO PARKER,
Appellants,
vs.

HARRY C. WESTOVER, individually and as
Former Collector of Internal Revenue for the
Sixth District of California, Appellee.

ELGIN R. PARKER and FLO PARKER,
Appellants,
vs.

R. A. RIDDELL, District Director of Internal Revenue,
Los Angeles, California, Appellee.

Transcript of Record

Appeals from the United States District Court for the
Southern District of California,
Central Division.

FILED

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No. 15340

United States
Court of Appeals
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ELGIN R. PARKER and FLO PARKER,
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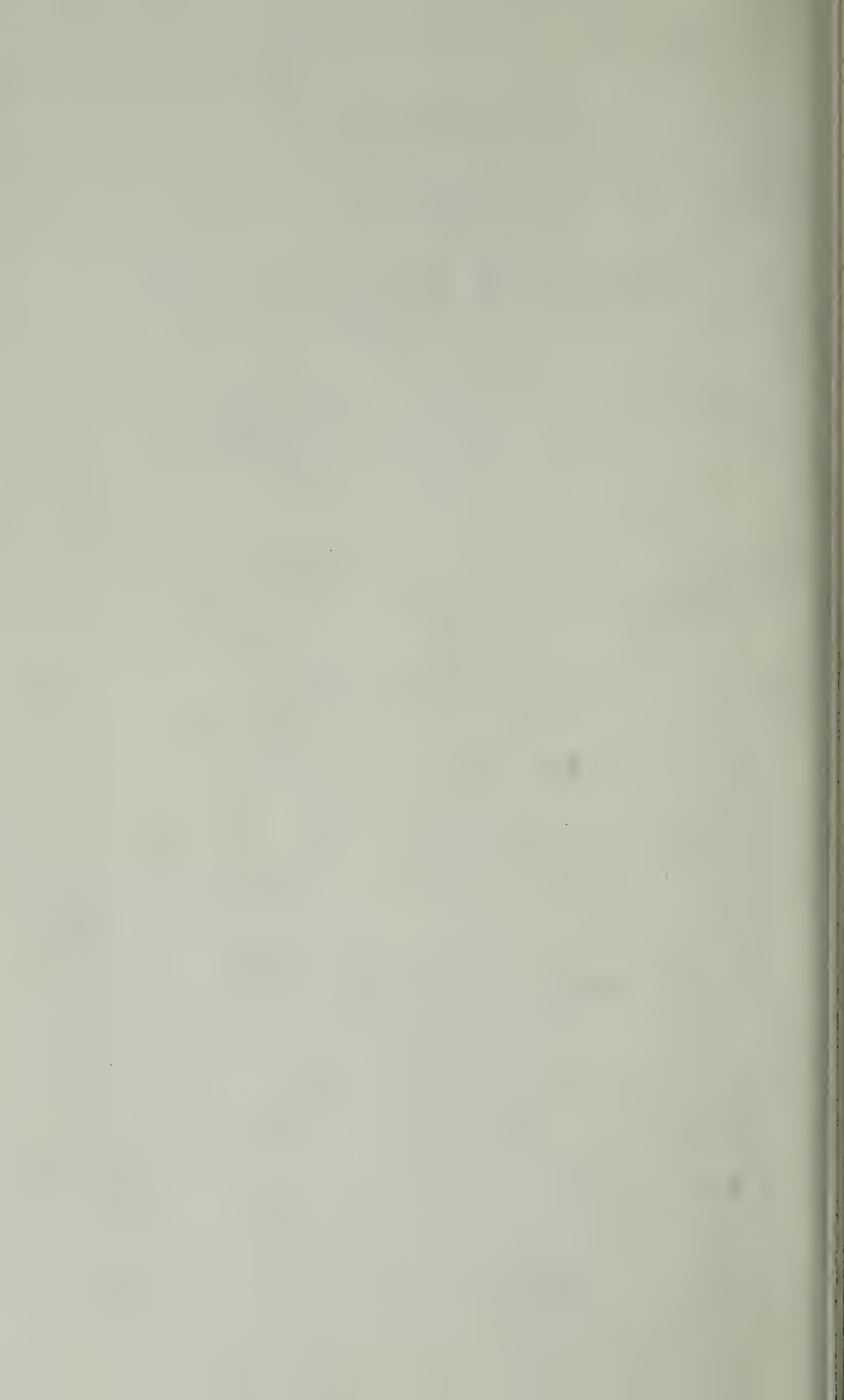
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[Clerk's Note: When deemed likely to be of an important nature, errors or doubtful matters appearing in the original certified record are printed literally in italic; and, likewise, cancelled matter appearing in the original certified record is printed and cancelled herein accordingly. When possible, an omission from the text is indicated by printing in italic the two words between which the omission seems to occur.]

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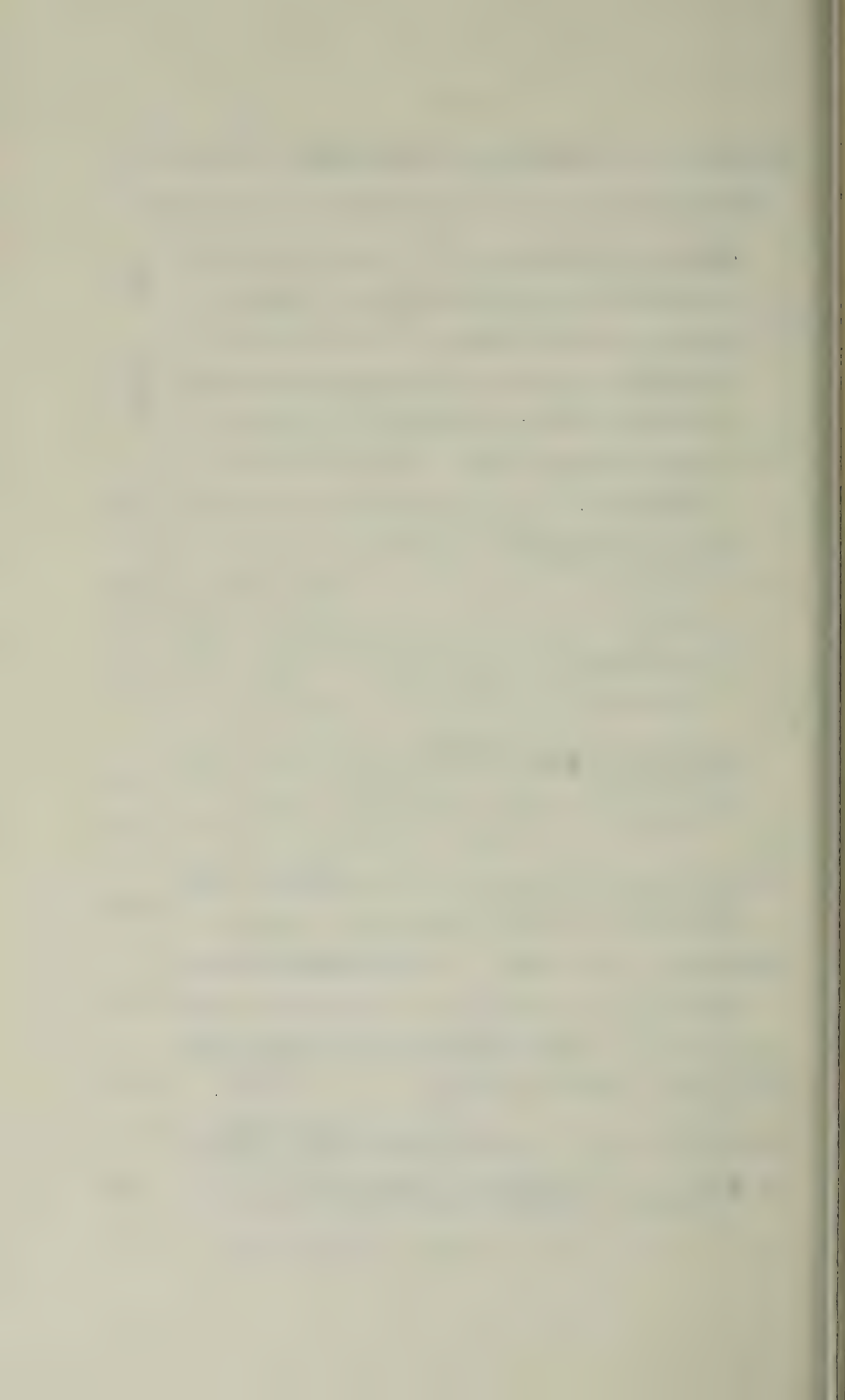
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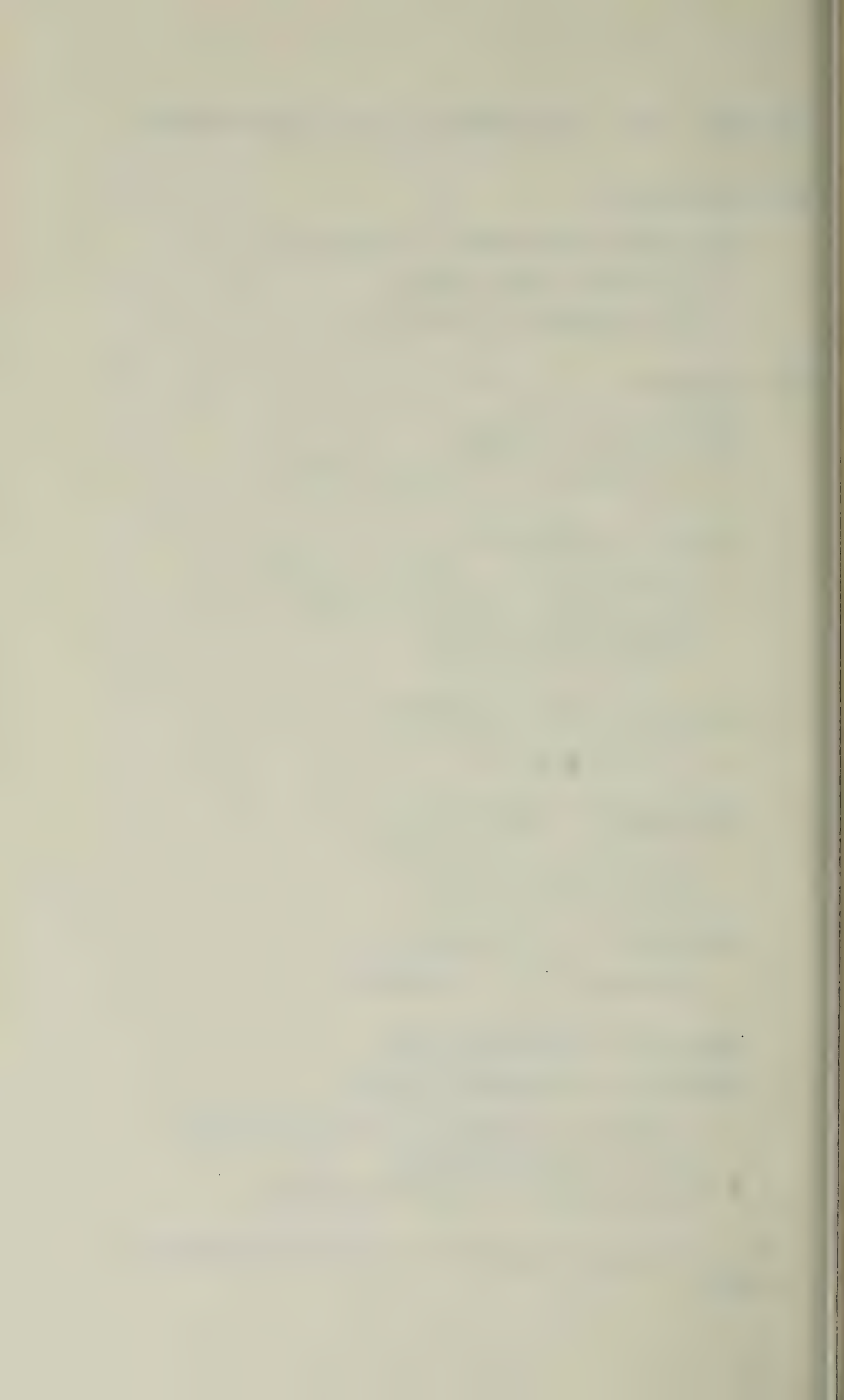
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• Page numbers appearing at foot of page of original Transcript of Record.



In the United States District Court, Southern
District of California, Central Division

No. 13,392-Y

ELGIN R. PARKER,

Plaintiff,

vs.

HARRY C. WESTOVER, Individually and as former Collector of Internal Revenue for the Sixth District of California, and R. A. Riddell, Individually and as Collector of Internal Revenue for the Sixth District of California,
Defendants.

AMENDED COMPLAINT FOR
RECOVERY OF TAXES

The amended complaint of the plaintiff, filed with the permission of the Court, respectfully shows to this Court and alleges as follows:

First Cause of Action

I.

That at all times herein mentioned the plaintiff was, and now is, an individual residing at 120 South Burris, Compton, California.

II.

The defendant, Harry C. Westover, during all the times mentioned herein up to October 31, 1949, was the duly appointed and acting Collector of Internal Revenue for the Sixth District of California,

and now resides at Los Angeles, California. [56]

The defendant, R. A. Riddell, from November 1, 1949, to the present time, was the duly appointed and acting Collector of Internal Revenue for the Sixth District of California, and has his office at Los Angeles, California.

The defendants are joined in this complaint for the reason that the plaintiff's right to relief against the two defendants arises out of the same transaction, or series of transactions or occurrences, and the same question of law and fact is common to both of the defendants. Plaintiff asks that the Court give judgment against the defendants according to their respective liabilities, which will depend upon the money paid to each of said defendants. Hereinafter, except in the prayer, the defendants will be called "defendant" irrespective of the particular defendant to which a particular payment of tax or interest was paid by the plaintiff.

III.

That on or about the 15th day of March, 1946, the plaintiff duly filed with the Collector of Internal Revenue for the Sixth District of California, federal income tax returns for the year 1945 in accordance with the Internal Revenue Code of the United States then in effect and paid to the defendant the amount shown below, which plaintiff believes to be the entire amount for which he was liable for income tax for the year 1945; the amount of \$35,-622.85 was paid between March 15, 1945 and March 15, 1946, and is not now in controversy.

IV.

On or about February 28, 1949, the plaintiff received from the defendant, as Collector of Internal Revenue as aforesaid, a Notice and Demand for payment of additional tax of \$46,401.28 plus interest of \$9,281.26, claimed to be due from plaintiff for his 1945 tax. [57]

V.

Plaintiff paid to the Collector of Internal Revenue for the Sixth District of California said deficiency and interest as follows:

Date	Tax and Interest
Paid to Defendant Harry C. Westover	
February 28, 1949.....	\$26,055.22
August 3, 1949.....	16,636.15
September 19, 1949.....	597.10
Paid to Defendant R. A. Riddell	
December 2, 1949.....	2,000.00
January 19, 1950.....	2,000.00
February 17, 1950.....	2,000.00
Paid to Defendant R. A. Riddell	
March 31, 1950.....	3,196.53
March 31, 1950.....	3,196.54
May 31, 1950.....	1.00
Grand Total	<u>\$55,682.54</u>

VI.

On August 23, 1950, within the statutory time therefore, plaintiff filed with the defendant, Collector of Internal Revenue for the Sixth District of California, his claim for refund of 1945 federal income tax in the amount of \$46,401.28 and interest

paid thereon. The ground for his claim was the same as will hereinafter be set forth in this complaint.

VII.

The Commissioner of Internal Revenue rejected the plaintiff's claim for refund by registered letter on March 20, 1951.

VIII.

Plaintiff brings this action under the provisions of Section 3772 of the Internal Revenue Code.

IX.

The deficiency of \$46,401.28 was due to the erroneous inclusion by the defendant and the Commissioner of Internal Revenue in plaintiff's 1945 gross income of \$54,411.54, being [58] one-quarter of the net income of a partnership known as "Southern Heater Company." Plaintiff did not own the quarter interest in said partnership and was not taxable on the quarter interest in said partnership income but the defendant and the Commissioner of Internal Revenue erroneously included such income in plaintiff's taxable income.

X.

As of October 31, 1943, plaintiff owned a half interest in a partnership known as Southern Heater Company. Plaintiff's wife, Flo Parker, owned the other half interest. On October 31, 1943, plaintiff gave to each of his four children a six and one-fourth per cent ($6\frac{1}{4}\%$) interest in the net assets, including goodwill, of the Southern Heater Company and on the same date his wife, Flo Parker,

gave a six and one-fourth per cent ($6\frac{1}{4}\%$) interest in said net assets to each of their four children. Said transfers and gifts were absolute and complete and without any conditions.

XI.

Plaintiff and his wife, Flo Parker, filed federal and state gift tax returns in which each showed that the value given to the four children totaled \$49,492.45. Plaintiff paid to the defendant on such gifts, federal gift tax in the amount of \$243.35.

XII.

Subsequently, the Commissioner of Internal Revenue determined that the transfers were complete and irrevocable and constituted taxable gifts and determined that the value of the gifts made by plaintiff to his four children aggregated \$106,250.00 and demanded additional gift taxes of \$7,774.15 from plaintiff. In arriving at the above values for gift tax purposes the Commissioner of Internal Revenue used a salary of \$12,000.00 per year for plaintiff in computing the past earnings and estimating the future earnings of the business, and in [59] determining the value of the goodwill of the business.

Plaintiff paid to the defendant the federal gift taxes as demanded, together with interest thereon.

XIII.

As a consequence of the transfers made by plaintiff and Flo Parker to their four children, plaintiff owned a 25% interest in said assets and busi-

ness, his wife owned a 25% interest in said assets and business, and his four children owned the other 50% interest in said assets and business. All six of them were tenants in common and it was necessary to have some formal organization through which the business could be carried on. Accordingly, plaintiff, the father of the children, filed in the Superior Court of the State of California in and for the County of Orange, in which County the parties were then living, a petition for appointment of guardian. In this proceeding, Docket No. A-11392, the Superior Court appointed plaintiff, the father, as guardian, provided he filed four corporate surety bonds of \$23,000.00 each. Such surety bonds were promised on condition that the proposed guardian obtain an order of the Court instructing the guardian to enter into a partnership agreement with the other owners of the business and instructing the guardian to keep the property of the wards invested in the partnership interests and instructing the guardian, as partner, to retain in the partnership some of the profits of the business. Such court authorizations were obtained and Letters of Guardianship to Elgin R. Parker, plaintiff, were thereupon issued.

XIV.

Plaintiff, individually and as the guardian, and plaintiff's wife, Flo Parker, signed the articles of co-partnership to take effect as of November 1, 1943.

Each partner in the partnership of Southern Heater Company had an equal voice in the manage-

ment of the business. [60] Hence, the Superior Court, which appointed the guardian of the four guardianship estates, had four votes against one for plaintiff and one for plaintiff's wife and the Court had control and management of the partnership business through the instrumentality of the guardian. Since November 1, 1943 the guardian has filed annual accounts with the Court and has the Court's approval thereon and has operated and managed the guardianship estates under the supervision and jurisdiction and under the orders of the Probate Court.

XV.

The partnership filed a certificate of fictitious firm name as required by California law and complied with other legal formalities. It has kept separate books of account, in which each partner's share of capital and income is credited to him.

XVI.

The total capital of Southern Heater Company as of November 1, 1944, was \$316,734.36. Of this amount the share belonging to the plaintiff's children was \$165,541.68, of which \$98,983.92 had been given by plaintiff and his wife to their four children, and \$66,557.76 had been contributed by the children as their original capital, being their share of the undrawn income for the year ended October 31, 1944.

XVII.

Plaintiff and his wife have continued to support their four children and none of the income of the

children has been used for their support or that of the parents.

XVIII.

The 1943 gifts by plaintiff and his wife to their four children of interests in the assets of the business, mentioned above, were completely valid and binding and vested in each child a 1/8th interest in the assets of the business of Southern Heater Company. Said gifts are irrevocable and the [61] income from said assets and interests of the children is not the income of plaintiff or his wife. Capital was a material income producing factor in the business of Southern Heater Company and the income from the children's portion of this capital was their own income and not the income of the parents. A salary equal to the value of the services rendered by plaintiff to the partnership has been paid and deducted before computing the distributable shares of the income of the partners.

XIX.

Plaintiff's children were partners with plaintiff and his wife in the business known as Southern Heater Company and each partner, including the children, is taxable on his or her distributive share of the partnership income and plaintiff is not taxable on any of the distributable shares of the partnership income which belong to his four children.

XX.

Plaintiff's total tax liability on his income tax return for the calendar year 1945 is \$35,622.85. Plain-

tiff has, upon the demand of the defendant, paid the defendant \$82,024.13 and has overpaid his 1945 income tax in the amount of \$46,401.28. Neither said amount nor any part thereof has been repaid to plaintiff and plaintiff is the owner of said claims.

XXI.

The members of the partnership of Southern Heater Company; namely, plaintiff, his wife, and said four children, endeavored at all times to have the partnership pay to plaintiff reasonable compensation for services he rendered to the said partnership. That the compensation of \$12,000.00 per year fixed at the time the said partnership was formed, was reasonable at that time. That the business of Southern Heater Company grew very rapidly throughout its existence due, in large part, to factors other than the value of plaintiff's services. If the value of [62] the services rendered by plaintiff to the partnership in the years 1945 or 1946 exceeded the \$12,000.00 per year the partnership paid plaintiff, then plaintiff is willing to have his taxes for those years computed upon the basis of allocating to him, from said partnership, a reasonable compensation, thereby reducing the distributable income of the partnership.

Second Cause of Action

I.

Plaintiff incorporates herein by reference as fully as though set out herein paragraphs I, II, VII, VIII, X, XI, XII, XIII, XIV, XV, XVII, XVIII and XIX of the First Cause of Action.

II.

That on or about the 15th day of March, 1947, the plaintiff duly filed with the Collector of Internal Revenue for the Sixth District of California, his federal income tax returns for the year 1946 in accordance with the Internal Revenue Code of the United States then in effect and paid to the defendant the amounts shown below, which plaintiff believes to be the entire amount for which he was liable for income tax for the year 1946:

March 12, 1946.....	\$ 5,000.00
April 30, 1946.....	325.04
June 7, 1946.....	12,000.00
July 31, 1946.....	325.04
September 16, 1946.....	18,000.00
October 31, 1946.....	325.04
January 15, 1947.....	8,700.00
January 31, 1947.....	325.03
March 15, 1947	5,168.13
	<hr/>
	\$50,168.28

These amounts are not now in dispute, excepting in the Third Cause of Action. [63]

III.

On or about February 28, 1949, the plaintiff received from the defendant, as Collector of Internal Revenue as aforesaid, a Notice and Demand for payment of an additional tax of \$61,079.27 plus interest of \$8,552.10 claimed to be due from plaintiff for his 1946 income tax.

IV.

Plaintiff paid to the Collector of Internal Revenue for the Sixth District of California, said deficiency and interest as follows:

Date	Tax and Interest
Paid to Defendant Harry C. Westover	
February 28, 1949.....	\$26,055.22
September 19, 1949.....	598.10
Paid to Defendant R. A. Riddell	
March 31, 1950.....	13,100.63
March 31, 1950.....	13,100.64
March 31, 1950.....	13,100.65
March 31, 1950.....	3,675.13
July, 1950	1.00
Grand Total	<u>\$69,631.37</u>

V.

On August 23, 1950, within the statutory time therefor, plaintiff filed with the defendant, the Collector of Internal Revenue for the Sixth District of California, his claim for refund of 1946 federal income tax in the amount of \$61,079.27 and interest paid thereon. The ground for his claim was the same as will be hereinafter set forth in this complaint.

VI.

The deficiency of \$61,079.27 was due to the erroneous conclusion by the defendant and the Commissioner of Internal Revenue in plaintiff's 1946 gross income of \$75,195.88, being one-quarter of the net income of a partnership known as Southern [64]

Heater Company. Plaintiff did not own the quarter interest in said partnership and was not taxable on the quarter interest in said partnership income but the defendant and the Commissioner of Internal Revenue erroneously included such income in plaintiff's taxable income.

VII.

Plaintiff's total tax liability on his own income for the calendar year 1946 is \$50,168.28. Plaintiff has, upon the demand of the defendant, paid the defendant \$111,247.55 and has overpaid his 1946 income tax in the amount of \$61,079.27. Neither said amount nor any part thereof has been repaid to plaintiff. Plaintiff is the owner of said claim.

VIII.

As of November 1, 1943, the total capital of said Southern Heater Company was \$400,298.87 of which \$217,671.76 was contributed by the four children of plaintiff and his wife, the amount of \$98,983.92 having been given by plaintiff and his wife to said children and the remainder or \$118,687.64 having been original contributions of capital to the partnership by the said children, having come from their share of the earnings for 1944 and 1945 which were retained in the business.

IX.

The members of the partnership of Southern Heater Company; namely, plaintiff, his wife, and said four children, endeavored at all times to have the partnership pay to plaintiff reasonable compen-

sation for services he rendered to the said partnership. That the compensation of \$12,000.00 per year fixed at the time the said partnership was formed, was reasonable at that time. That the business of Southern Heater Company grew very rapidly throughout its existence due, in large part, to factors other than the value of plaintiff's services. If the value of the services rendered by plaintiff to the partnership in [65] the years 1945 or 1946 exceeded the \$12,000.00 per year the partnership paid plaintiff, then plaintiff is willing to have his taxes for those years computed upon the basis of allocating to him, from said partnership, a reasonable compensation, thereby reducing the distributable income of the partnership.

Third Cause of Action

I.

Plaintiff incorporates herein by reference as fully as though set out herein paragraphs I, II, VII, VIII of the First Cause of Action, and paragraphs II, III, IV of the Second Cause of Action.

II.

On March 15, 1950, within the statutory time therefor, plaintiff filed with the defendant, the Collector of Internal Revenue for the Sixth District of California, his claim for refund of 1946 income tax in the amount of \$676.89. The ground for his claim was the same as will be hereinafter set forth in this Third Cause of Action.

III.

In 1946 plaintiff paid to the Collector of Internal Revenue interest of \$848.23 on additional 1943 gift tax. Through inadvertence no deduction was taken on the 1946 return for such item.

IV.

The interest paid by plaintiff to defendant on said additional federal gift tax is deductible under the provisions of Section 23(2)(b) of the Internal Revenue Code.

V.

Neither the amount of \$676.89 nor such further amount as is legally refundable, nor any part thereof, has been repaid to plaintiff. The plaintiff is the owner of said claim.

By reason of the premises the defendants became and are [66] indebted to the plaintiff as follows:

First Cause of Action

Defendant, Harry C. Westover, is indebted to the plaintiff in the amount of \$43,288.47 plus interest at 6% per annum on \$26,055.22 from February 28, 1949; on \$16,636.15 from August 3, 1949; and on \$597.10 from September 19, 1949.

Defendant R. A. Riddell, is indebted to the plaintiff in the amount of \$12,394.07 plus interest at 6% per annum on \$2,000.00 from December 2, 1949; on \$2,000.00 from January 19, 1950; on \$2,000.00 from February 17, 1950; on \$6,393.07 from March, 1950; and on \$1.00 from May 31, 1950.

Second Cause of Action

Defendant, Harry C. Westover, is indebted to the plaintiff in the amount of \$26,653.32 with interest at 6% per annum on \$26,055.22 from February 28, 1949; and on \$595.10 from September 19, 1949.

Defendant, R. A. Riddell, is indebted to the plaintiff in the amount of \$42,978.05 with interest at 6% per annum on \$42,977.05 from March 31, 1950; and on \$1.00 from July 1, 1950.

Third Cause of Action

Defendant, Harry C. Westover, is indebted to the plaintiff in the amount of \$676.89 plus interest thereon at 6% per annum from March 15, 1947, until repaid to plaintiff, plus costs of this suit, together with such other relief as seems proper to the court.

Dated: _____, 1952.

/s/ MELVIN D. WILSON,

/s/ JOSEPH D. PEELER,

/s/ EUGENE T. GARRETT

Attorneys for Plaintiff.

Duly Verified.

[Endorsed]: Filed December 23, 1952.

Dated this 28th day of June, 1955.

/s/ MELVIN D. WILSON,

Counsel for Plaintiffs

LAUGHLIN E. WATERS,

United States Attorney,

EDWARD R. McHALE,

Assistant United States Attorney,

EUGENE HARPOLE,

Special Attorney,

Internal Revenue Service,

/s/ By EDWARD R. McHALE

Be It So Ordered. Dated: July 7th, 1955.

/s/ LEON R. YANKWICH,

Judge

[70]

[Endorsed]: Filed July 7, 1955.

[Title of District Court and Cause No. 13,392.]

ANSWER TO AMENDED COMPLAINT
FOR RECOVERY OF TAXES

Defendants answer as follows:

Alleged First Cause of Action

I.

Admit the allegations contained in Paragraph I
of the Amended Complaint.

II.

Admit the allegations contained in Paragraph II
of the Amended Complaint, except that defendants
deny that plaintiff is entitled to judgment in any
amount against either defendant.

III.

Admit the allegations contained in Paragraph III of the Amended Complaint, except defendants deny that said amount represented plaintiff's [117] entire tax liability for the year 1945.

IV.

Admit the allegations contained in Paragraph IV of the Amended Complaint.

V.

Deny all of the allegations contained in Paragraph V of the Amended Complaint, except admit or aver that the deficiency and interest were paid, abated or satisfied by credits (the latter representing over-assessments to plaintiff's children on the same income here in question) in installments and on the dates set forth in Certificate of Assessments and Payments, Form 899, dated October 24, 1952, attached hereto as Exhibit "A" and made a part hereof.

VI.

Admit the allegations contained in Paragraph VI of the Amended Complaint, except deny the correctness, validity and legal effectiveness of each and every allegation therein, and denies that the allegations set forth in said claim are sufficient to constitute a legal and valid claim for refund.

VII.

Admit the allegations contained in Paragraph VII of the Amended Complaint.

VIII.

Admit the allegations contained in Paragraph VIII of the Amended Complaint.

IX.

Deny all of the allegations contained in Paragraph IX of the Amended Complaint.

X.

Deny all of the allegations contained in Paragraph X of the Amended Complaint.

XI.

Admit the allegations contained in Paragraph XI of the Amended [118] Complaint.

XII.

Admit the allegations contained in Paragraph XII of the Amended Complaint.

XIII.

Deny all of the allegations contained in Paragraph XIII of the Amended Complaint, except admit that Elgin R. Parker filed a petition for appointment of a guardian, as alleged; that said Elgin R. Parker was appointed guardian and his bonds fixed in the amount as alleged; that the Court issued orders authorizing the guardian to enter into an agreement as alleged; and entered the authorizations and issued the letters of guardianship as alleged.

XIV.

Deny all of the allegations contained in Paragraph XIV of the Amended Complaint, except ad-

mit that Elgin R. Parker, individually, and as guardian, together with plaintiff's wife, Flo Parker, signed the articles of co-partnership as alleged.

XV.

Defendants aver that they are without knowledge or information sufficient to form a belief as to the truth of any of the allegations contained in Paragraph XV of the Amended Complaint.

XVI.

Deny all of the allegations contained in Paragraph XVI of the Amended Complaint.

XVII.

Answering Paragraph XVII of the Amended Complaint, defendants aver that they are without knowledge or information sufficient to form a belief as to the truth of any of the allegations contained in Paragraph XVII.

XVIII.

Deny all of the allegations contained in Paragraph XVIII of the Amended Complaint. [119]

XIX.

Deny all of the allegations contained in Paragraph XIX of the Amended Complaint.

XX.

Deny all of the allegations contained in Paragraph XX of the Amended Complaint, except admit that no part of the amount paid as shown by

Exhibit "A" attached hereto has been refunded, and admit that plaintiff is the owner of the alleged claim, limited, however, to the amounts actually paid, as distinguished from the amounts abated or credited shown on the Certificate of Assessments and Payments attached hereto. Defendants aver that plaintiff is not entitled to recover any amount in this action, and further, in the alternative, if the Court should hold otherwise, plaintiff is not entitled to recover any amount shown in said Certificate as having been credited, since for the purposes here concerned such amounts do not represent amounts paid by the plaintiff herein.

XXI.

Deny the allegations contained in Paragraph XXI of the Amended Complaint that plaintiff entered into a valid partnership with his wife and children and that \$12,000.00 per year constituted a reasonable compensation for plaintiff's services rendered to the Southern Heater Company. Defendants admit that the business of Southern Heater Company grew very rapidly throughout its existence but deny that such growth was due to factors other than the value of plaintiff's services. Defendants aver that the business of Southern Heater Company grew solely because of the value of plaintiff's services and that plaintiff's reasonable compensation for his services to the Southern Heater Company is considerably in excess of \$12,000.00 per year.

Alleged Second Cause of Action

I.

Defendants answer the allegations contained by reference in Paragraph I in the same manner as defendants answer Paragraphs I, II, VII, VIII, X, XI, XII, XIII, XIV, XV, XVII, XVIII and XIX of the Alleged [120] First Cause of Action.

II.

Admit the allegations contained in Paragraph II, except deny that the taxes were paid on the dates or in the installments alleged, and aver that such taxes were paid in the installments and on the dates as set forth in the Certificate of Assessments and Payments attached hereto as Exhibit "A", and further deny that such taxes constituted plaintiff's entire tax liability for the year 1946.

III.

Admit the allegations contained in Paragraph III, except deny that interest was assessed in the amount alleged and aver that interest was assessed in the amount of \$8,552.10, of which the amount of \$598.10 was abated, all of which is set forth in Exhibit "A" attached hereto.

VI.

Deny all of the allegations contained in Paragraph IV and aver that the deficiency and interest were paid, abated or satisfied by credits (the latter presenting overassessments to plaintiff's children on the same income here in question) in the man-

ner, in the amounts and on the dates set forth in Exhibit "A" attached hereto.

V.

Admit the allegations contained in Paragraph V of the Amended Complaint, except deny the correctness, validity and legal effectiveness of each and every allegation therein, and deny that the allegations set forth in said claim are sufficient to constitute a legal and valid claim for refund.

VI.

Deny all of the allegations contained in Paragraph VI of the Amended Complaint.

VII.

Deny all of the allegations contained in Paragraph VII, except admit that no part of the amount paid as shown by Exhibit "A" attached hereto has been refunded, and admit that plaintiff is the owner of the alleged claim, limited, however, to the amounts actually paid, as [121] distinguished from the amounts abated or credited, shown on the Certificate of Assessments and Payments attached hereto. Defendants aver that plaintiff is not entitled to recover any amount in this action, and further, in the alternative, if the Court should hold otherwise, plaintiff is not entitled to recover any amount shown in said Certificate as having been credited, since for the purposes here concerned such amounts do not represent amounts paid by the plaintiff herein.

VIII.

Deny all of the allegations contained in Paragraph VIII.

IX.

Deny the allegations contained in Paragraph IX of the Amended Complaint that plaintiff entered into a valid partnership with his wife and children and that \$12,000.00 per year constituted a reasonable compensation for plaintiff's services rendered to the Southern Heater Company. Defendants admit that the business of Southern Heater Company grew very rapidly throughout its existence but deny that such growth was due to factors other than the value of plaintiff's services. Defendants aver that the business of Southern Heater Company grew solely because of the value of plaintiff's services and that plaintiff's reasonable compensation for his services to the Southern Heater Company is considerably in excess of \$12,000.00 per year.

Alleged Third Cause of Action

I.

Defendants answer the allegations contained by reference in Paragraph I in the same manner as defendant answered Paragraphs I, II, VII and VIII of the Alleged First Cause of Action and Paragraphs II, III and IV of the Alleged Second Cause of Action.

II.

Deny all of the allegations contained in Paragraph II, except admits that plaintiff filed with the Collector of Internal Revenue on or about March

15, 1950, an instrument purporting to be a claim for refund in the amount of \$676.89. [122]

III.

Admit the allegations contained in Paragraph III.

IV.

Admit the allegations contained in Paragraph IV.

V.

Deny all of the allegations contained in Paragraph V, and aver that the alleged deduction was granted and allowed in full. All income taxes resulting from the allowance of the deduction were duly abated.

LAUGHLIN E. WATERS,
United States Attorney

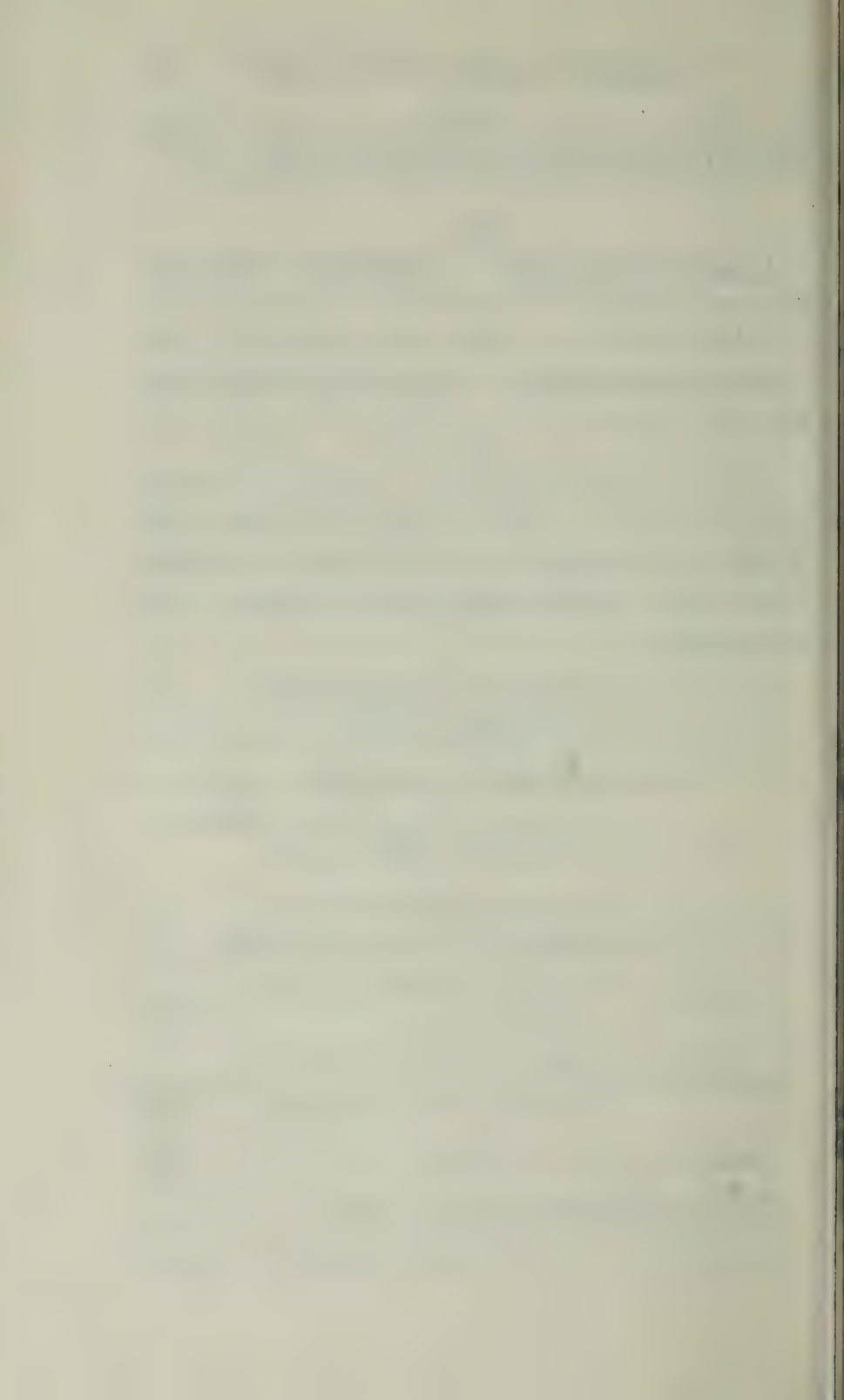
EDWARD R. McHALE,
Assistant United States Attorney,
Chief, Tax Division

EUGENE HARPOLE and
SIDNEY J. MACHTINGER,
Attorneys, Internal Revenue
Service

/s/ By SIDNEY J. MACHTINGER,
Attorneys for Defendants [123]

Affidavit of Service by Mail Attached. [126]

[Endorsed]: Filed April 26, 1956.



CERTIFICATE OF ASSESSMENTS AND PAYMENTS

Form 899
TAX DEPARTMENT
REVENUE SERVICE
February 1954

DISTRICT DIRECTOR OF INTERNAL REVENUE
LOS ANGELES, CALIFORNIA

In re: **Elgin Parker**
(Name of taxpayer)
Box 629, Compton, Calif.
(Address)

COMMISSIONER OF INTERNAL REVENUE:
ATTENTION:

(Refer to symbols and date of letter requesting this certification)

Following is a transcript of the records of this office covering the accounts of the taxpayer named

in respect to **Income**
(Character of tax)
1945-1946
(Period covered)

1. LIST AND YEAR	2. ACCT. NO. OR PAGE AND LINE	3. AMOUNT ASSESSED	PAID, ABATED, OR CREDITED		7. PAID AS CR.	8. ADJUSTMENT OF OVERASSESSMENTS
			5. DATE OR SCHEDULE NO.	6. AMOUNT		
/49 nt.to	519047 7/15/49	T 46,40128 I 9,28026	2/28/49	26,055	22 Pd	1040 3002244 2720 RAR
			8/3/49	16,636	15 Pd	
			9/19/49	597	10 Abt.	
			12/2/49	2,000	00 Pd	
			1/19/50	2,000	00 Pd	
			2/17/50	2,000	00 Pd	
			3/31/50	3,196	53 Cr.	
			3/31/50	3,196	54 Cr.	
			5/31/50	1	00 Tr.	
SC 7/15/49 AR 7/18/49 7/20/49 /49 nt.to	519048 7/15/50	T 61,07927 I 8,55110	2/28/49	26,055	22 Pd.	1040 3034691 2720 RAR
			9/19/49	598	10 Abt.	
			3/31/50	13,100	64 Cr.	
			3/31/50	13,100	63 Cr.	
			3/31/50	13,100	65 Cr.	
			3/31/50	13,100	65 Cr.	
			3/31/50	3,675	13 Cr.	
SC 7/15/49 AR 7/18/49 7/20/49		I 100				Tr. to 7-531926-50
SC 7/15/49 AR 7/18/49 7/20/49		I 100				Tr. to 7-531927-50

CERTIFY that the foregoing transcript of the accounts of the taxpayer named above in respect to the specified, is true and complete for the period stated, and that all assessments and payments of tax, and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office, are shown therein.

Certificate **April 26,** 19**56.**

W. L. Kiddle

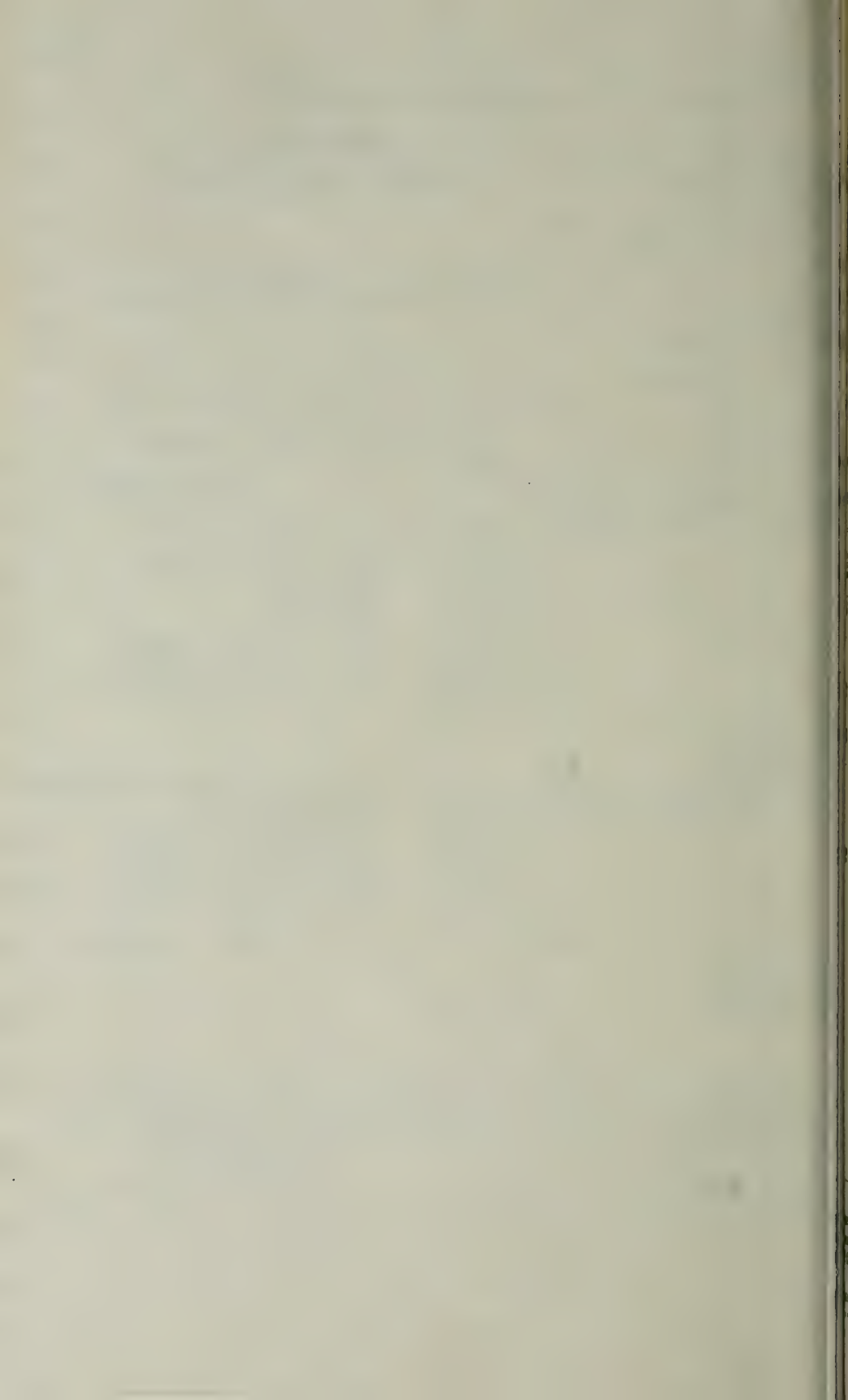


Exhibit "A"--(continued)

CERTIFICATE OF ASSESSMENTS AND PAYMENTS

TO THE DISTRICT DIRECTOR OF INTERNAL REVENUE

In re: **Elgin Parker**

(Name of taxpayer)

LOS ANGELES, CALIFORNIA

Box 629, Compton, Calif.

(Address)

TO THE COMMISSIONER OF INTERNAL REVENUE:

ATTENTION:

(Refer to symbols and date of letter requesting this certification)

The following is a transcript of the records of this office covering the accounts of the taxpayer named

in respect to **ESTIMATED - INCOME**

(Character of tax)

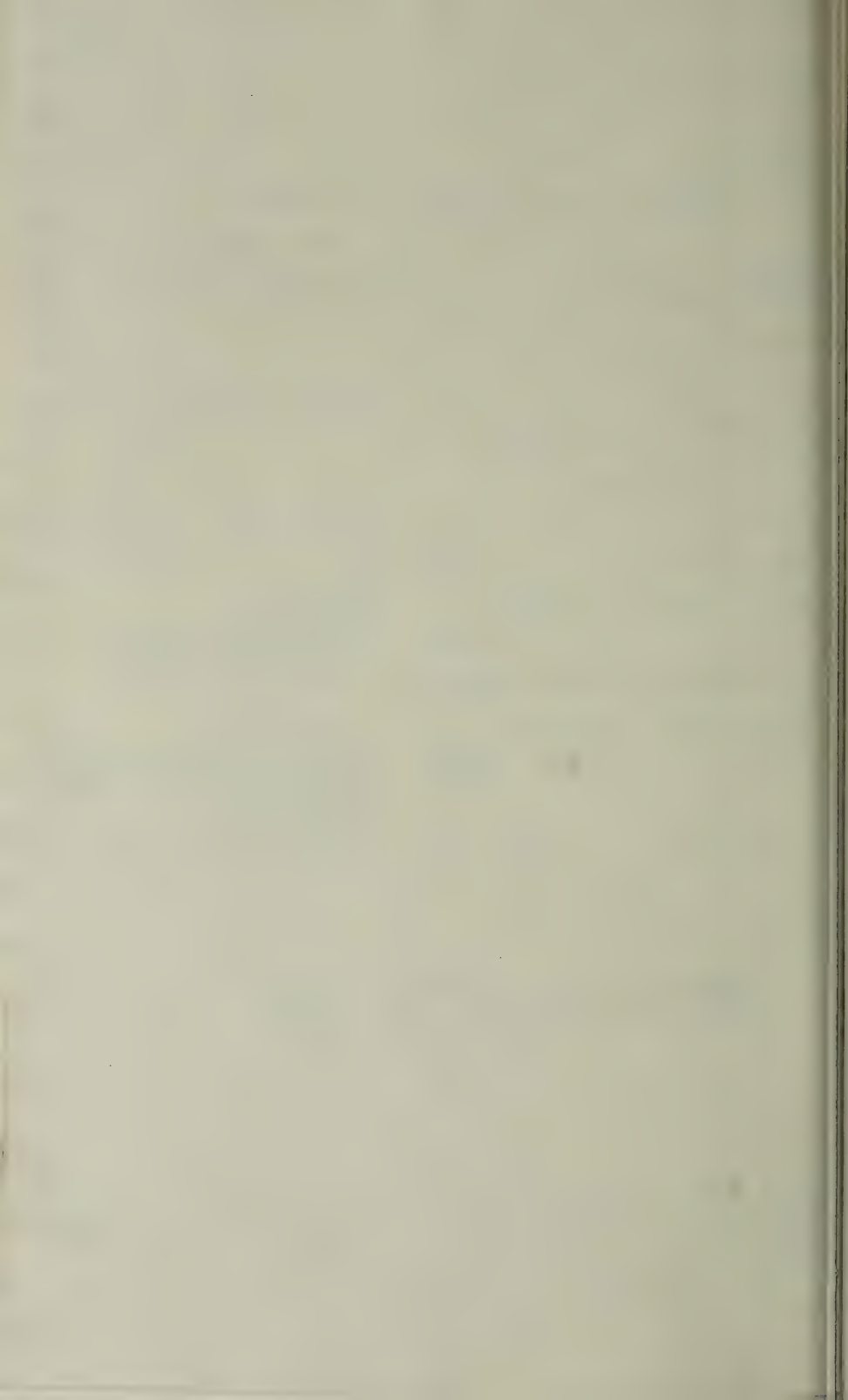
1945 - 1946

(Period covered)

1. LAST AND YEAR	2. ACCT. NO. OR PAGE AND LINE	4. AMOUNT ASSESSED	PAID, ABATED, OR CREDITED		7. PAID AS. CR.	8. ADJUSTMENT OF OVERASSESSMENTS
			5. DATE OR SCHEDULE NO.	6. AMOUNT		
1945	1113927	T 41,500 00 (old Balance)	7/7/45 9/17/45	10,375 00 10,375 00 10,375 00 10,375 00	Pd Pd Pd Pd	5106401 5272728
1945	3803244	T 4,497 85	Mar. 1946	4,497 85	Pd	
1946	1111868	T 20,000 00	7/2/46 11/4/46 2/18/47	5,000 00 12,000 00 18,000 00 8,700 00 23,700 00	Pd Pd Pd Pd Bal.	6/7/46 1900455 9/16/46 1922574 1/15/47 1958048
1946	3034691	5,168 13	3/15/47	5,168 13	Pd	
Prepayment by Withholding from Wages:						
Forms W-2 - Year 1946						
<u>Employer</u>		<u>Employee</u>		<u>Tax Withheld</u>		
Southern Heater Corp.		E.R. Parker		2,209 15		
American Control Corp.		E.R. Parker		391 00		
				2,600 15		
		1/2 community share		1,300 08		

I CERTIFY that the foregoing transcript of the accounts of the taxpayer named above in respect to the specified, is true and complete for the period stated, and that all assessments and payments of tax, interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office, are shown therein.

Date of certificate **April 26,** 19**56.**



[Title of District Court and Cause No. 13392.]

DECISION

The above entitled cause heretofore tried, argued and submitted is now decided as follows:

Judgment will be for the defendant, that the plaintiff take nothing by his complaint.

Costs to the defendant. Findings and judgment to be prepared by counsel for the defendant under local Rule 7.

Comment

This is another family partnership case in which plaintiff seeks to recover income taxes for the fiscal years ending October 31, 1945, 1946, 1947 and 1948. A case involving the tax for the fiscal year ending October 31, 1944, decided by a jury against the taxpayer, was affirmed on appeal. (*Parker v. Westover*, 9 Cir., 1950, 186 F.2d 49)

When the present case first came before me, on [131] consideration, I sustained without the taking of any testimony the plea of the Government that the judgment as to the year 1944 was *res judicata*. That ruling was reversed on appeal. (*Parker v. Westover*, 9 Cir., 1955, 221 F.2d 603) The case has now been tried and facts fully presented and argued.

There is a tendency in some Courts of Appeals to assume that because of the liberalization of the rule of partnerships contained in the 1951 Amendment to § 191 of the Internal Revenue Code, (Internal Revenue Act of 1950, § 340(a), (b) and (c)), questions relating to partnerships coming into

existence before the effective date of that Amendment shall be treated by the same criteria which the Amendment set forth. (Alexander v. Commissioner, 8 Cir., 1952, 194 F.2d 921; Parker v. Westover, 9 Cir., 1955, 221 F.2d 603, 606-607) However, the Congress, itself, in enacting the more liberalized rule, stated specifically:

“The determination as to whether a person shall be recognized as a partner for income tax purposes for any taxable year beginning before January 1, 1951, shall be made as if this section had not been enacted and without inferences drawn from the fact that this section is not expressly made applicable with respect to taxable years beginning before January 1, 1951.” (§ 340) (Emphasis added)

So we are back to the general criteria laid down by the Supreme Court in Commissioner v. Culbertson, 1949, 337 U.S. 733, 742-743:

“The question is not whether the services of capital contributed by a partner are of sufficient importance to meet some objective standard supposedly established by the Tower case, but whether, considering all the facts—(1) the agreement, [132] (2) the conduct of the parties in execution of its provisions, their statements, the testimony of disinterested persons, (3) the relationship of the parties, (4) their respective abilities and capital contributions, (5) the actual control of the income and the purposes for which it is used, and (6) any other facts throwing light on their true intent—the parties in good faith and acting with a business purpose intended to join together in the present

conduct of the enterprise. There is nothing new or particularly difficult about such a test. Triers of fact are constantly called upon to determine the intent with which a person acted." (Numbering added)

As stated at the conclusion of the trial, the taxpayer in this case has shown fairness in dealing with the income allocated to the minor children in the partnership. On the whole, however, I am satisfied that if we apply the six criteria laid down in the Culbertson case, the conclusion must be that the partnership was not created to fulfill any legitimate business purpose, that the business continued to be controlled by the parents who created it, and that, despite compliance with state law and periodical reports of the father, as guardian, the partnership, cannot, for tax purposes, be considered as entered into in good faith. (See, *Schlobohm v. United States*, 1952, 105 F.S. 593; *Helvering v. Clifford*, 1950, 309 U.S. 330; *Toor v. Westover*, 9 Cir., 1953, 200 F.2d 713; *Snyder v. Westover*, 9 Cir., 1954, 217 F.2d 928, 935 (1).

Hence the ruling above made.

Dated this 15th day of June, 1956.

/s/ LEON R. YANKWICH,

United States District Judge [133]

[Endorsed]: Filed June 15, 1956.

1. Since this opinion was written the Court of Appeals for the Ninth Circuit in *Smith v. Westover*, No. 14594, decided July 23, 1956, sustained

the judgment in another case in which the facts were very similar to the facts in this case. The following language of the opinion is very appropriate to the situation here

“Furthermore, it would seem that an obvious device of this sort by husband and wife to provide for the future of their minor children without any business purpose involved should not be sanctioned. This business had been operated as community property and was under the control of the husband. The capital which was taken out for the purpose of making it under the sole control of the husband was paid back in and the wife and children given ostensible interests for no apparent purpose except to build up an estate in the children at the expense of the United States. We think the law does not require us to sanction such an obvious device.”

(Slip decision, pages 4 and 5. Opinion not yet reported in 235 F.2d——) [134]

[Endorsed]: Filed Oct. 11, 1956.

[Title of District Court and Causes 13392, 13391, 18772, 18773.]

OBJECTIONS TO FORM AND CONTENT OF PROPOSED FINDINGS OF FACT AND CONCLUSIONS OF LAW

Plaintiffs herein respectfully object to the Proposed Findings of Fact and Conclusions of Law served upon their counsel July 2, 1956, in the following particulars:

A. The Proposed Findings of Fact are erroneous in that they contain incorrect statements of ultimate fact as follows:

Finding No. III.

It incorrectly states that the partnership of Mr. and Mrs. Parker commenced January, 1942, whereas the uncontradicted evidence shows that such partnership commenced November 1, 1942.

Finding No. IV.

1. This Finding omits the fact that the partnership formed by Mr. and Mrs. Parker, on November 1, 1942, had a substantial contribution of capital from each, and in the second sentence thereof infers that capital was not a material income producing element of the business. There is no controversy in the record to the fact that capital was a substantial income producing element of the business and that the expansion of the business and the increased earnings could not have been obtained [136] except for the capital investment, both by way of contributed capital and retained earnings.

2. The sentence commencing on line 12 is incorrect in that the plaintiffs actually gave their children interests by written deeds of gift—the language on line 13, therefore, which states “purported to give” is incorrect.

3. The deeds of gift reflect that Mrs. Parker gave to each of her four then living children a one-sixteenth interest in the partnership, its assets and business, and that Mr. Parker by written deed of

gift gave to each of his four then living children a one-sixteenth interest in the partnership, its assets and business. The words "one-eighth" on line 14 should be changed to "one-sixteenth".

4. The last sentence of the Finding is incomplete in that it fails to include the statement that additional gift taxes were assessed by the Government and paid by the plaintiffs.

Finding No. V.

1. The sentence beginning at line 27 states that the partnership agreement was entered into with the "consent" of the Superior Court. More appropriate language would be to say that the partnership agreement was entered into after the "approval" thereof by the Superior Court. The agreement, as approved, included a provision for an initial salary of \$12,000.00 per year for E. R. Parker.

2. The last sentence of the Finding is incorrect in that it states that the same capital and the same management continued as before the organization of the partnership. The record is clear and uncontradicted [137] that the capital which formed the initial capital of this partnership was contributed by each of the partners and that each of the children, as partners, with the approval of the Superior Court, contributed assets, the cost of which was \$24,745.98. The evidence is also clear that the capital needs of the business after 1943 were supplied by the retention of earnings and therefore constituted additional contributions of capital by each of

the partners substantially in proportion to their participation.

3. The last sentence of the Finding is also erroneous in that it recites that the same management continued as before the organization of the partnership. This is erroneous in that Mr. Parker, acting as manager, operated the business, but the management, by the partnership agreement, was given to each of the partners, and Mr. Parker, therefore, acted not only for himself, but in the fiduciary capacity as representative of the children. The four minor partners, represented by the guardian, under the supervision of the Superior Court, had four out of a total of six votes on partnership matters.

Finding No. VII.

This Finding is wrong in stating that the only disbursement to the guardianship estates was that of \$3,750.00 to each of the four children during 1945. Exhibit 60 demonstrates that in addition to this disbursement there were additional disbursements made as follows:

Year ended October 31, 1944: \$14,927.54.

Year ended October 31, 1945: 10,423.25.

Year ended October 31, 1946: 2,723.69. [138]

Year ended October 31, 1947: \$16,736.52.

Year ended October 31, 1948: 406.47.

Finding No. X.

The second and third sentences are inaccurate in that the record shows that the capital upon the formation of the partnership was contributed from

property owned by Mr. Parker and Mrs. Parker and by each of the four children. In addition, capital was contributed by all six partners from retained earnings of the business, and records were scrupulously kept showing precisely the amount of retained earnings and the amount attributable to each of the six partners.

Finding No. XI.

1. The first sentence of the proposed Finding is in the nature of a conclusion of law, rather than a Finding of fact. Whether or not the purposes for which the gifts were made and the partnership created come within the meaning of the term "business purpose", as used by the courts, is a question of law to be determined from the ultimate facts. This sentence should, therefore, be deleted.

2. The second sentence is incomplete in that it uses the phrase "help the children". The testimony of both Mr. and Mrs. Parker, and that of the two boys, was to the effect that the gifts were made in order to provide financial security for the children, as well as to provide an inducement for them to go into the family business. The phrase "help the children" should be changed to "provide financial security for the children". Such a change would be not only in accord with the evidence, but is also in accord with the remarks by the Trial Court at the [139] conclusion of oral argument.

3. The purposes expressed by the witnesses are credible in light of all the circumstances, particularly in view of the fact that as the Court itself has

found, each of the plaintiffs showed complete fairness in dealing with the allocation of income from the partnership to the minor children. The evidence amply shows that the intention to provide financial security for the children has been fulfilled, and that the hope for their entering into the business, while not fulfilled, is still a distinct possibility. The inducement is still working. The third sentence of the proposed Finding, therefore, is not in accordance with the preponderance of the testimony and the reasonable inferences to be drawn therefrom.

4. The last sentence of the proposed Finding is erroneous in stating that none of the children had expressed a determination to enter into the business, whereas each of the two boys showed a present inclination to enter into the family business. This testimony is uncontradicted.

Finding No. XII.

The statement in the first sentence to the effect that the economic substance of the business was not changed after the deeds of gift to the children were made is immaterial, but is erroneous in that the economic substance was changed. The children from the time of the creation of the partnership had substantial economic interests therein. These interests were not defeasible. The transaction by which the interests had been obtained was taxed, and the father, as guardian, became and remained accountable [140] for the proportion of earnings attributable to the respective interests of the children.

Finding No. XV.

The last sentence of the Finding is erroneous and contradicts the first sentence of the Finding. Capital was a material income producing factor. This capital included not only that which was invested by all of the partners at the inception of the partnership, but also retained earnings attributable to each partner's share. Mr. Parker's testimony is uncontradicted and unqualified to the effect that without the retention of capital the business of the partnership would not have been able to expand and to prosper as it did. There is no evidence whatsoever that contradicts this or from which an inference could be made that capital was not the material income producing factor.

Finding No. XVI.

1. The first sentence of this Finding is clearly erroneous in its statement that all the income of the partnership was earned by Mr. Parker. The income was earned by the partnership. As the Government indicates in its proposed Finding XV, that income resulted from the services of Mr. Parker and also from the capital contributed at the outset and throughout the life of the partnership. There is no evidence whatsoever to support the finding that the income was earned by Mr. Parker.

2. To say that the partnership made no real change in the economic or financial status of the Parker family, is not only without support in the record, but is absolutely and positively contradicted by the record. The economic and financial status of

[141] each of the Parker children changed from zero, prior to the making of the gifts, to \$24,745.98 after the gifts were made and to a total of \$88,339.92 at the time the partnership was terminated in 1948. That was a real change and one made by reason of the gifts and the partnership.

Finding No. XVII.

This proposed Finding is not material. Neither is it a Finding of an ultimate fact, but rather is the quotation of two isolated instances in the transcript. If the salary of \$12,000.00 paid to Mr. Parker was a reasonable one, there should be such a finding. If the Government contends that the salary should have been \$52,000.00, it should have proposed a finding to that effect, rather than to quote from one of the documents in the record.

Finding No. XVIII.

It is submitted that this Finding is not supported by the record. More important, however, is that it is immaterial in that it applies the old fashion standard of the family partnership cases and does not recognize the changes in the applicable law as reflected in the more recent cases of *Parker v. Westover* 221 Fed. (2d) 603; *Pike v. U.S.* February 16, 1956, C.A. 9; *Snyder v. Westover* 217 Fed. (2d) 928; *Commissioner v. Eaton* 210 Fed. (2d) 653; *Toor v. Westover* 200 Fed. (2d) 713.

In addition to the Findings of Fact proposed by defendant, plaintiffs submit that the following additional Findings of Fact should be made to the end

that the Findings will reflect all the relevant facts relating to the partnership and its income: [142]

I.

Commencing shortly prior to 1940, and continuing until the Fall of 1943, Elgin R. Parker and his wife, Flo Parker, had upon numerous occasions discussed the desirability of making gifts to their then children. Prior to the time that the gifts were made on October 31, 1943, each had decided and determined that it would be desirable to make gifts to the children in order to provide financial security for their future and in order to serve as an inducement for their entering into the family business. The first of these two motives was the more important reason for the making of such gifts.

II.

At the time the plaintiffs decided to make gifts, neither had consulted with any accountant or attorney with regard thereto. Mr. Parker was aware that income taxes might be saved by making gifts. At the time the gifts were made, on October 31, 1943, Mrs. Parker was not aware of any tax saving that would result.

III.

From the time the guardianship proceedings were instituted by Mr. Parker on November 1, 1943, throughout the entire period of the partnership and continuing until the time when the two daughters became of age, and continuing until the present time for the two sons, the interests of the children have at all times been subject to the jurisdic-

tion of the Superior Court of the State of California in and for the County of Orange. Mr. Parker throughout the period of the partnership each year filed annual reports with the Court indicating precisely the amount of partnership income attributable to each child's share in the partnership and accounting for all funds received or disbursed. Since the partnership terminated in 1948, Mr. Parker, as guardian for the children, [143] has continued to file annual accounts with said Court showing the assets, disbursements and receipts for the account of each child. The guardian, during all the years involved, presented many special problems to the Superior Court and obtained instructions thereon.

IV.

The interests of each of the children at the commencement of the partnership and thereafter until its termination in the way of capital investment including contributed capital and accumulated earnings were as follows:

October 31, 1943: \$24,745.98.

October 31, 1944: 41,385.42.

October 31, 1945: 54,417.94.

October 31, 1946: 89,292.19.

October 31, 1947: 75,592.75.

October 31, 1948: 84,589.92.

Note: This fact not mentioned in the Proposed Findings by the Government, is one of the particular matters cited by the Court as being relevant and material in *Parker v. Westover*, 9 Cir., 221 Fed. (2d) 603, 606.

V.

Throughout the entire period of the partnership, from November 1, 1943, until October 31, 1948, the income attributable to the interests of the children from the partnership was fairly allocated to them in accordance with their respective interests.

VI.

The partnership complied in all respects with the laws of the State of California.

VII.

The conduct of Mr. Parker, individually, and as guardian for the four children, and the conduct of Mrs. Parker, [144] in carrying out the provisions of the partnership agreement, is consistent with their having entered into the partnership in good faith.

VIII.

The gifts by Mr. and Mrs. Parker to the children were made October 31, 1943. Articles of partnership were executed by and on behalf of the partners on February 25, 1944. If the Superior Court of the State of California in and for the County of Orange had not approved the investment of the children's assets in the partnership, the business would have been forced to dissolve, and the children's assets would have been invested otherwise.

IX.

No part of the earnings of the partnership attributable to the interests of the four children was

at any time used by Mr. Parker or Mrs. Parker for the support, maintenance or education of such children.

X.

The interests of the four children as partners were reflected in all dealings involving the disclosures of the partners, including the filing of tax returns, obtaining of franchises and licenses, and the filing of financial reports.

XI.

The two daughters of plaintiffs reached their majorities in 1951 and 1953 and their guardianship estates (less some assets withheld for adjustment on account of income taxes) were distributed to them and in the following years their guardianships were terminated.

XII.

As of April 30, 1946, the partnership transferred its water heater manufacturing business and the manufacture of control devises to two corporations in exchange for their [145] stocks which were issued to and held by the partnership. The real estate was leased on a long-term basis to one of the corporations. As of September 30, 1948, the real estate was transferred to a third corporation whose stock was issued to and held by the partnership.

As of October 31, 1948, the partnership was terminated and its assets distributed to the six partners, including the four guardianship estates.

After April 30, 1946, the partnership was passive, merely holding stocks, leased real estate, and notes.

XIII.

The plaintiffs had become bankrupt in 1936 as a result with dealing in real estate. The heater manufacturing business had always been profitable for them, and the partnership composed of the plaintiffs and the four children was not authorized to and did not engage in real estate transactions.

XIV.

Elgin R. Parker as guardian was required to secure and deposit in each guardianship estate, a surety bond of \$23,000.00.

Dated this 9th day of July, 1956.

Respectfully,

MUSICK, PEELER & GARRETT,
MELVIN D. WILSON,
JOHN P. POLLOCK,

/s/ By MELVIN D. WILSON,

Attorneys for Plaintiffs

[146]

Affidavit of Service by Mail attached.

[Endorsed]: Filed July 10, 1956.

United States District Court, Southern District
of California, Central Division

No. 13,392-Y Civil

ELGIN R. PARKER, Plaintiff,

vs.

HARRY C. WESTOVER and R. A. RIDDELL,
Defendants.

No. 13,391-Y Civil

FLO PARKER, Plaintiff,

vs.

HARRY C. WESTOVER and R. A. RIDDELL,
Defendants.

No. 18,772-Y Civil

ELGIN R. PARKER, Plaintiff,

vs.

R. A. RIDDELL, Defendant.

No. 18,773-Y Civil

FLO PARKER, Plaintiff,

vs.

R. A. RIDDELL, Defendant.

FINDINGS OF FACT, CONCLUSIONS
OF LAW AND JUDGMENT [148]

The above-entitled cases were consolidated for
trial and came on regularly for hearing before the

Court without the intervention of the jury on May 1, 1956, and trial was concluded on May 3, 1956, the Honorable Leon Yankwich, Chief Judge, presiding. Plaintiffs were represented by their counsel, Musick, Peeler and Garrett through Melvin D. Wilson and John P. Pollock and the defendants were represented by their counsel, Laughlin E. Waters, United States Attorney for the Southern District of California, Edward R. McHale, Assistant United States Attorney, Chief, Tax Division, Robert H. Wyshak, Assistant United States Attorney, and Sidney J. Machtinger, Attorney, Internal Revenue Service. The Court having heard and considered all of the evidence and having read and considered the briefs submitted by each side, makes the following findings of fact and conclusions of law:

Findings of Fact

I.

Plaintiffs Elgin R. Parker and Flo Parker are husband and wife and are residents of the State of California, County of Los Angeles, within the jurisdiction of this Court. Plaintiffs in these actions seek refunds of income taxes paid for the calendar years 1945, 1946, 1947 and 1948, in the total amount of \$282,164.96.

II.

Plaintiffs timely filed claims for refund of the taxes sought to be recovered herein and timely filed suits for refund after rejection of such claims on behalf of the Commissioner of Internal Revenue.

III.

Since the late nineteen thirties, plaintiff Elgin R. Parker had been engaged in a business known as Southern Heater Company. This business consisted of the manufacturing and selling of gas water heaters. Commencing in November, 1942 and until October 31, 1943, this business was operated as a partnership by the plaintiffs with each of them owning a one-half interest therein. [149]

IV.

Plaintiff Flo Parker rendered no services whatsoever to this partnership. Starting with little capital, plaintiff Elgin R. Parker had increased the income of the Southern Heater Company from the date of its inception in the late nineteen thirties until October 31, 1943 so that for the fiscal year ended October 31, 1943 the Southern Heater Company showed a net profit of \$193,000. Plaintiffs on November 1, 1943 had four children, Flo Diane Parker, Patricia Lee Parker, Roland Tibbets Parker and Arthur Elgin Parker, who then were 14, 11, 6 and 3 years old, respectively. In 1945 plaintiffs had a fifth child who is not involved in the instant cases. On October 31, 1943, Elgin R. Parker and Flo Parker, by written deeds of gift, each gave to each one of their then four minor children an undivided one-eighth interest in the partnership then conducted by the parents under the name of Southern Heater Company. This left the parents with a one-fourth interest each in the Southern Heater Company and the children with a one-eighth interest each. Federal gift tax returns were filed by the donors for the year 1943 reporting

the gifts to the four children and gift taxes paid.

V.

On November 1, 1943 Elgin R. Parker petitioned the Superior Court of Orange County, California wherein the plaintiffs were then residing, for an appointment of himself as guardian of the assets of his four children, which had been transferred to these children by the deeds of gift. This petition was granted and an order appointing the father as guardian of his children was made by the Superior Court on December 31, 1943. After his appointment as guardian, Elgin R. Parker, with the consent of the Superior Court, entered into a general partnership agreement between himself as guardian of his four children, himself as an individual, and his wife, Flo Parker, for the purpose of carrying on the business of the Southern Heater Company. This general partnership agreement was effective November 1, 1943, the day after the deeds of gift to the children. The business of the Southern Heater Company was continued [150] after November 1, 1943 in the same place with the same capital under the same management of Elgin R. Parker.

VI.

Subsequent to the formation of the partnership on November 1, 1943 the net income of the Southern Heater Company was as follows:

Fiscal Year Ended	Income
October 31, 1944.....	\$263,928.92
October 31, 1945.....	229,646.15
October 31, 1946.....	307,983.48
October 31, 1947.....	26,696.66
October 31, 1948.....	57,629.12

VII.

Despite the large partnership earnings and profits during the years in question the only disbursement to the guardianship estate out of the business profits was a disbursement of \$3,750 in United States war bonds to each of the four children during the year 1945. At the termination of the partnership on October 31, 1948, the only assets which the children had in their guardianship estates were stocks in various corporations, and notes given by the plaintiffs for monies borrowed by the parents from the guardianships. The corporations had been formed in 1946 and succeeding years to take over certain partnership assets and operations in exchange for their stock which the partnership held.

VIII.

Neither the children nor Flo Parker contributed any services to the partnership at any time, nor did they participate in the management or control thereof.

IX.

Although Elgin R. Parker, as guardian of the children's estates, filed annual reports with the Superior Court, he exercised sole control in the operation of the Southern Heater Company and subsidiary corporations. Permission of the Superior Court was neither sought nor obtained for the operation of the business. At no time was any act of Elgin R. Parker as guardian in the guardianship proceedings opposed by any party nor was any petition or request by him to the Superior Court denied. [151]

X.

All of the capital used in the operation of the business of the Southern Heater Company came from the operations and profits of the company. None of the capital originated from sources outside the business. Neither Flo Parker nor the children contributed any capital towards the operation of the business. The amount of capital in the business was not changed in any way because of the creation of the guardianships or because of the deeds of gift to the children on October 31, 1943. Although Elgin R. Parker ostensibly represented the children as their guardian, he did not operate the business after November 1, 1943 in any manner different from the way it had been operated prior to November 1, 1943.

XI.

Plaintiffs had no business purpose in making the deeds of gift to their children or in the creation of the general partnership. Plaintiffs' sole, expressed purpose was to help the children and to provide an inducement for the children to enter the business of the family. This expressed purpose is not credible and lacks foundation when considered in light of the fact that plaintiffs created a general partnership which rendered the entire interest of the children subject to claims of creditors and in light of the tender ages of the children during the period of the partnership involved herein. To this date none of the plaintiffs' children has actively entered into the business of the plaintiffs or even expressed a determination so to enter the business when he is of age.

XII.

The creation of the general partnership following the deeds of gift to the children of an interest in the going business affected the titular ownership of the business and the legal form but not the economic substance thereof. The additional partners after October 31, 1943 had no business affect whatsoever on the operation of the Southern Heater Company. [152]

XIII.

Overassessments of the taxes paid by the guardianship estates for the calendar years 1944 through 1948 were made by the Commissioner of Internal Revenue, when he determined that all income earned by the Southern Heater Company during those years was taxable to the parents and that the partnership arrangement was merely a reallocation of income within the family group.

XIV.

Plaintiffs, with the approval of the Superior Court, borrowed the refunds due the children and applied them toward the additional taxes resulting from the Commissioner's determination. Notes were issued therefor.

XV.

During the fiscal years ended October 31, 1945, 1946, 1947 and 1948 the income of the Southern Heater Company was produced entirely as the result of the personal services of Elgin R. Parker and of the capital which the Southern Heater Company had at the commencement of the partner-

ship and which was additionally accumulated from retained earnings. Capital was not a material income producing factor of the Southern Heater Company during the years involved.

XVI.

All of the income from the partnership business allocated to the guardianship estates for the Parker children was earned by Elgin R. Parker. The partnership made no real change in the economic or financial status of the Parker family.

XVII.

During the years 1944, 1945 and 1946 Elgin R. Parker received a salary of \$12,000 from the partnership for services rendered in its behalf. In a statement filed with the Superior Court in the guardianship proceeding Elgin R. Parker's attorney on his behalf stated that "the father received a salary of but \$12,000, whereas the services were worth at least \$52,000 per year." [153]

XVIII.

Considering all of the facts—the deeds of gift, the partnership agreement, the conduct of the parties, the execution of the provisions of these gifts and agreement, statements and testimony of the witnesses, the relationship of the parties, their respective abilities and capital contribution, the actual control of the income allocated to the guardianship estates and all other facts throwing light on their true intent, the parties did not in good faith and acting with a business purpose intend

that the guardianship estates should join together with the plaintiffs herein in the present conduct of the partnership enterprise known as the Southern Heater Company.

XIX.

Each and every conclusion of law which is deemed a finding of fact is hereby found as a fact.

From the foregoing findings of fact the Court draws the following:

Conclusions of Law

I.

The Court has jurisdiction of these actions and of the parties thereto.

II.

During the fiscal years ended October 31, 1945, 1946, 1947 and 1948, neither Elgin R. Parker, as guardian for his children, Flo Diane Parker, Patricia Lee Parker, Roland Tibbets Parker and Arthur Elgin Parker, nor his said children were partners in the operation of the business known as the Southern Heater Company within the meaning of the Internal Revenue Code. None of the income from said business should be attributed to Elgin R. Parker as guardian of the estates of the above-named children or to the children themselves.

III.

Plaintiffs have not sustained their burden of proving that during the fiscal years ended October 31, 1945, 1946, 1947 and 1948, plaintiffs Elgin R. Parker and Flo Parker in good faith and acting

[154] with a business purpose intended that their children or Elgin R. Parker as guardian of the estates of his four children join together with them as a partner in the present conduct of the Southern Heater Company.

IV.

Plaintiffs have not proved that a business purpose existed for the inclusion of their children or Elgin R. Parker, as guardian of the estates of his four children, as a partner with them in the business of the Southern Heater Company.

V.

Plaintiffs did not over pay their Federal income taxes for the years 1945, 1946, 1947 and 1948.

VI.

Neither of the plaintiffs is entitled to recover anything on the complaints herein, and judgments should be entered dismissing the complaints with prejudice, the defendants to have judgments for their costs.

VII.

Each and every finding of fact which is deemed a conclusion of law is hereby found as a matter of law.

Judgment

In accordance with the foregoing findings of fact and conclusions of law, it is hereby ordered, adjudged and decreed:

That the plaintiffs take nothing by their complaints; that the complaints may be and are dis-

missed with prejudice and that the defendants have judgment for and shall recover from plaintiffs the amount of their costs to be taxed by the clerk of this court in the sum of \$20.00 in each case.

Dated: This 11th day of July, 1956.

/s/ LEON R. YANKWICH,
United States District Judge

Affidavit of Service by Mail attached. [156]

[Endorsed]: Lodged June 29, 1956. Filed July 11, 1956. Docketed and Entered July 12, 1956.

[Title of District Court and Causes No. 13391-2.]

NOTICE OF APPEAL

Notice Is Hereby Given that Elgin R. Parker and Flo Parker, plaintiffs in the above captioned consolidated cases, hereby appeal to the United States Court of Appeals for the [157] Ninth Circuit from the final judgment entered in the above consolidated cases on July 12, 1956.

MUSICK, PEELER & GARRETT
MELVIN D. WILSON
JOHN P. POLLOCK

/s/ By JOHN P. POLLOCK

Attorneys for Appellants [158]

Certificate of Service by Mail Attached.

[Endorsed]: Filed August 13, 1956.

[Title of District Court and Causes No. 18772-3.]

NOTICE OF APPEAL

Notice Is Hereby Given that Elgin R. Parker and Flo Parker, plaintiffs in the above captioned consolidated cases, hereby appeal to the United States Court of Appeals for the [159] Ninth Circuit from the final judgment entered in the above consolidated cases on July 12, 1956.

MUSICK, PEELER & GARRETT
MELVIN D. WILSON
JOHN P. POLLOCK

/s/ By JOHN P. POLLOCK

Attorneys for Appellants [159]

Certificate of Service by Mail Attached.

[Endorsed]: Filed August 13, 1956.

[Title of District Court and Causes 13391-2,
18772-3.]

STATEMENT OF EVIDENCE

Condensation of Oral Testimony Given at the Trial

Elgin R. Parker called as a witness on behalf of the plaintiffs, being first duly sworn, testified as follows:

Direct Examination

My name is Elgin R. Parker and I am one of the plaintiffs in this case.

I am a manufacturer of water heaters, gas and electric. I have been engaged in that business since 1920.

In the early days in the 1920's I was individually operating in that business under a fictitious name as sole proprietor. I also engaged as a side-line activity in real estate as a speculator or investor on my own account during the years 1920's up to 1930, 1931. When the Depression set in, the real estate that was encumbered was not worth the encumbrance. That threw me and my wife into bankruptcy in 1936.

I worked as an executive in the water heater business for another company from about 1930 to about 1937 or 1938. After the termination of the bankruptcy, I went back into the manufacture of water heaters under the name of Southern Heater Company, a fictitious name, and made it a sole proprietorship which I owned, as community property.

In 1942 I formed a partnership with my wife under the name of Southern Heater Company and a certificate of fictitious firm name was filed. This business had previously been the community property of myself and wife, and we changed our community interests to separate interests and became partners, each having a half interest.

Before November of 1943, Southern Heater Company in which my wife and myself were equal partners, operated a heater business and had a factory in Compton, California. In 1939 we opened a branch in Bessemer, Alabama. In February of 1941 the Compton plant burned down. We then moved the machinery from the Alabama plant to California and rebuilt the building and operated at one plant thereafter.

In addition to making gas and electric water heaters, we made controls and parts to go into the heater. No patents are necessary on the manufacture of gas and electric water heaters.

As of 1943 the Southern Heater Company had perhaps a few over 100 employees, maybe 125. The company had salesmen and distributors at various places. It was a fully integrated manufacturing and selling operation.

After we had been out of bankruptcy some time, my wife and I discussed the possibility of making gifts to the children to give them some security in the event we should become bankrupt again. In 1940 when we were returning from Alabama, we discussed very seriously if we could work out some way where we could provide for their security in future years. The purpose was to give the children some security in the event of the death of either or both of us or bankruptcy of our business venture. This matter was discussed with James Maynard our chief engineer. It was also discussed with my father-in-law many times. Mrs. Parker and I discussed it many, many times.

By mid-1943 we had four children, Dian born in 1929, Patricia born in 1932, Roland born in 1937, and[167] Arthur born in 1941. Another daughter, Nancy, was born in 1945 which was after the gifts of interests in the business to the children.

In 1942 we arrived at a determination to make gifts to the children. Thereafter we discussed the best form of making such gifts, and in 1943 we really started working on it. My wife and I agreed

to make gifts and then in 1943 we talked it over with our auditor and he said it was a legal matter and he suggested that we go to our attorney with it. The purpose of making the gifts was to give the children the assets that would protect them in case of any bad business decision of my own or bad business in general, and also we would like some of the children to go into the business to perpetuate it if that was possible.

I was aware that there would be a tax advantage in making the gifts, if there was any profit. There wasn't any assurance that there was going to be any profit. I did not discuss the tax advantages with my wife, or with Mr. Maynard or with my father-in-law. These possible tax advantages had nothing to do with my decision to make the gifts. I would have made the gifts if there would have been no tax advantages whatsoever.

"The Court: Let me ask you this question. You gave an answer and didn't elaborate. You said that one of the advantages you considered before you went to see Mr. Wilson was the fact that they would have something if something happened to you. Didn't you know, under the rule of partnership in California, and everywhere else, that the assets of the partnership are liable for the mistakes of one partner, and that you, as the managing partner, could hypothecate them and lose the money, and they would be liable for that? Didn't you know that? Did you figure by splitting it up you sort of erect a fence around that half, that couldn't be [168] touched if you went broke again?

The Witness: Well, your Honor, the minute we went into the partnership, and the Probate Court accepted it, the Probate Court had the voice. They had four votes against my wife's and mine, too, on any decisions.

The Court: But you were still running the business afterwards?

The Witness: I was still running the business.

The Court: And if you incurred debts, the Probate Court could not refuse to let you pay them out of the share, because the partnership would be liable. That was before you went to Mr. Wilson. I wanted to know where you got this idea that by giving this to the children you were insuring that against creditors. Did you think that the creditors of the partnership, or, rather, didn't you know that under the laws of California, specifically, the assets of the partnership are liable for the debts incurred by the managing partner? Didn't you know that?

The Witness: The way I understand, that there are only——

The Court: Did you think if you incurred a lot of debts, the Probate Court could refuse to allow you to pay the shares of the children against those debts, so that you would not go broke again? I am just trying to think where you found the advantages before you went there. You are talking about the advantages you discussed with this auditor, and I want to know where you got these fantastic ideas, because your lawyer will tell you they are not based on law, and I will read you the sections of the Code which say specifically that the partnership is

liable, not only for the debts, but even for the torts of the partnership, and putting them in probate would not erect a Chinese wall around them, [169] and protect them against your mistakes, especially as to debts that you incurred as the managing partner? Where did you get the idea?

The Witness: We had another object, too, your Honor. We wanted to tie the children into the business, and perpetuate the business, if it was possible.

The Court: That is when they grew up?

The Witness: Yes, sir.

The Court: I see. All right.

Q. (By Mr. Pollock): Mr. Parker, along that same line, going back to this bankruptcy, was it the heater business that went into bankruptcy, or was it otherwise?

Mr. Wyshak: That has already been answered, your Honor.

The Court: No, let him explain it. He was in the heater business, and he went into bankruptcy, and I don't suppose he kept any of the assets out of the bankruptcy. I hope he doesn't admit doing that. That is why I asked him if he went into bankruptcy individually. He was the business." [170]

in the business and the courts decided that the guardianship estate should not keep its funds in that business, the business would have to be liquidated. I was willing to go ahead with the gifts of the interests in the business nevertheless.

Gift tax returns were filed on the gifts of interests in the business to the children based on the book value of the assets. The Internal Revenue

Bureau increased the value and assessed additional taxes which were paid. My wife also filed similar returns and paid original taxes and paid additional gift taxes on said gifts.

The gifts were made and thereafter the partnership agreement was entered into. The salary of \$12,000.00 a year payable to me under the partnership agreement was the same amount I had been receiving from the partnership with my wife. I continued to receive that salary until April 30, 1946 when the manufacturing assets were transferred to a corporation. Thereafter I received a reduced salary of \$200.00 per month from the partnership. These amounts were the only amounts of salary or compensation or bonuses I drew from the partnership during its entire existence. None of the other partners drew any salary, compensation or bonus at any time during the existence of the partnership.

Partnership books of account were set up after the formation of the partnership and they were kept by the bookkeeper, Mrs. Fierke.

As of May 1, 1946, the water heater manufacturing assets of the partnership were transferred to Southern Heater Corporation for all of its stock; the assets for manufacturing controls were transferred to the American Control Corporation for all of its stock, and the real estate and the stocks were retained in the partnership. Thereafter my salary in the partnership was reduced to \$200.00 a month.

Guardianship proceedings were started in 1943 immediately after the gifts were made. Two of the guardianships have been terminated because the

two girls have become of age and I have been discharged as guardian. The other two guardianships are still in existence. The guardianship proceedings were started in Orange County as at that time we lived in Orange County, at Seal Beach, California.

“Mr. Pollock: We offer as Exhibit 37 a document entitled, “Application for Instruction on Investment of Funds of Ward,” filed in the Superior Court March 29, 1950.

Mr. Wyshak: Your Honor, I will object to that as irrelevant and immaterial, it being subsequent to the years in issue. The last taxable year in question is the year 1948, and anything happening subsequent to that year would be self-serving and incompetent.

The Court: Of course, initially the guardianship was established almost simultaneously with the establishment of the partnership. I think the guardianship, of course, depends upon the partnership, but the fact that it continues may not be very significant. Nevertheless, I think the plaintiffs in this case should show or be allowed to show that while the partnership was terminated—in fact, the partnership was terminated in 1948, and it had a clause permitting any partner to terminate it,—

Mr. Wyshak: Exactly.

The Court: —and it had no life at all, I mean no definite life, and it could have been terminated—

Mr. Wyshak: At any time.

The Court: —at any time if either the husband or the wife wanted to terminate it, and the Probate Court could not have stopped it. Neverthe-

less, they should be allowed to show that so far as the guardianship is concerned, they still [172] considered themselves under the direction of the court as far as disposing of the funds of such of the two children as were still minors.

The objection is overruled. We will discuss the effect later on."

Annual statements of the assets and liabilities of the partnership of Southern Heater Company were regularly prepared and filed in the guardianship proceedings.

I filed a bond in the four guardianship proceedings for \$23,000 each, the cost of which was claimed as an expense of the guardianship proceeding.

My oldest daughter, Dian, is 27 years of age now. She is married. Her husband works for the Parker Realty Corporation. He intends to study denistry this fall in San Francisco. He has worked for the Parker Realty Corporation on and off for two years. The Parker Realty Company owns the land and building which house Southern Heater Corporation's manufacturing operations. Parker Realty Company received that real estate from the partnership in 1948 in consideration of issuing its stock to the partnership.

My second daughter is Patricia Lee Parker, who is now 24 and married, her name being Brown. Her husband is temporarily working for Parker Realty also and he is going to enter Orange County College in June for the the summer session. They live in Costa Mesa, California.

"Q. Do you know whether or not the son-in-law is planning to go into the family business?

Mr. Wyshak: Objected to as irrelevant and incompetent, your Honor.

The Court: I will sustain the objection. We are getting beyond the second generation now. I don't think we ought to be worried about what these girls with money are doing for their husbands. It is nice they are helping them [173] to be educated. So let's forget about that. The intention to go into business relates to children, not to in-laws, after majority. I cannot retroject now to 1942 the intention of Mrs. Brown to marry the particular man. She probably did not have any intention then at all. She was probably still in high school and playing the whole field. You know, having a daughter, I know that is when they play the field, when they are in high school. That is when you have to worry about it."

My oldest boy's name is Roland Tibbetts Parker. He will be a freshman this fall at U.S.C. taking a business administration course. From 1942 through 1948 he worked every summer and some weekends for one of our companies. Since 1948 he has also worked for one of the companies in summers and over weekends. He has worked around the shop and every branch of it [174] and also in the office.

My second son is Arthur Parker and he is in Compton High School, second year. He worked for the partnership in 1947 and 1948 and since 1948 in one of the corporations, Southern Heater Corporation or American Control Corporation or Parker Realty Company, in summers and vaca-

tions and some weekends. He has done mechanical work in the shops and some clerical work. I tried to have both boys get some all-around knowledge of the business. We train many of our employees as salesmen and service men, and we followed this same course with our boys, but we have given them a more extensive training than we have our other employees.

The American Control Corporation has a separate plant from the Southern Heater Corporation plant. The Parker Realty Company office is at the Southern Heater Corporation plant.

Our fifth child, Nancy, was not alive when we made the original gifts to the other children, but we have set up a trust and given her some property. Our two oldest daughters are the trustees for the youngest daughter. We made these gifts to her to try to equalize what the other children had. Mrs. Parker joined with me in that gift. None of the children's income from the partnership or guardianships have been used in the support or maintenance of the children. Mrs. Parker and I have supported them out of our income.

The years 1943 through 1946 were war years. Business was all being done under priorities and materials were scarce. The War Production Board would change its rules very often and these were what you would call "hectic" years. Every time they would change their rules on the material we could use, we had to redesign and refit and then try to get materials that would fit the new set of conditions. We were very fortunate inasmuch as

when they changed their rules we seemed to be [175] able to redesign fast and get into production so that our company was in a very expanding business. That expansion took place over the period 1943 through 1946, a very great expansion. After the corporations were formed in 1946 the expansion continued until about 1954.

When material was scarce as it was in 1943 to 1946, it was necessary for the company to have cash so that if they found material it could pay for it in cash. Otherwise, it couldn't stay in business. It was not only necessary to have the capital to stay in business but to expand the business. Otherwise, the business would have dried up.

The partnership during the years 1943, 1944 and 1945 and up until April of 1946 retained the earnings in the business, except the amounts necessary to pay the taxes.

I considered the salary of \$12,000 per year that I drew from November 1943 until the spring of 1946 to be an agreeable and adequate salary.

When we made the gifts to the children, we knew we had to get the approval of the court to invest their assets in the business. As long as the business was profitable and growing we hoped to keep the children's money in the business because it was the most profitable place for it. If the business had turned out otherwise it was my intention to pull out of the guardianship funds and get them into a safer investment. I was right on the job and knew just exactly what the business was doing, whether it was making money or not.

I have made attempts to familiarize my children with the business. All of them worked in the business. I have never attempted to tell them how much they had or how well off they were because I thought maybe it might kill their incentive to work. I continually discussed with them the matter [176] of going into the business. I have never forced the issue. I have tried to make it attractive to them so that it would be profitable for them to enter the business, but if they decided otherwise I wasn't going to force the issue on them.

From 1943 to 1946 the business had a controller, C. Fierke. She was drawing about \$4,000.00 a year. It had a sales manager, G. McGaughey, who drew \$6,000.00 a year.

The partnership Southern Heater Company filed income tax returns for each year in the period 1943 to 1948. I filed income tax returns for that period and as guardian for the children I filed income tax returns for each of them. Mrs. Parker filed returns for each of those years. The returns filed by all six of us showed our shares of the partnership earnings.

If Mrs. Parker and I had to pay the income taxes on our share of the partnership income and on the children's share of the partnership income, in about three and a half years, starting with 1944, we would have had no interest left in the business and the children would have owned it all. We expected when the gifts were made that the children would pay their tax on their share of the income.

Cross Examination

Questions by Mr. Sydney H. Machtinger, Special Attorney, Internal Revenue Service.

About 1938 I bought the business of Southern Heater Company. At that time it was performing the same type of business that it followed after I purchased the company. It had about thirty people at the time I purchased it. Since I purchased it I have done every type of work in the company from janitor to general manager.

I estimate that the income for the year 1938 was about \$30,000.00 and in 1939 a similar amount. [177] About 1940 I would estimate it at \$60,000.00; 1941 I would estimate \$90,000.00; 1942 about \$140,000.00. The business was on an October 31st fiscal year. For the year ended October 31, 1943, I think the income was about \$150,000.00. It is obvious that up to the beginning of the war years the company could be made to grow. What would happen to it after the war started, no one could tell. It is also obvious that to keep the business growing it would have to retain the capital that was in the business, and if any capital were taken out around October 31, 1943, it is obvious that it would not continue to grow at the same rate.

The business was not so hectic from 1940 to 1943 as the war effort had not yet affected the company. As of October 31, 1943, conditions were such that I could not tell what the business would be like in the following three years because new war regulations were coming out every week and every day. This was true throughout the year 1943.

Mrs. Parker and I considered from 1940 on giving the children some gifts. By the end of 1942 we had seriously considered giving them an interest in the assets of the business.

Melvin Wilson, the attorney to whom we went for the formation of the partnership with the children, had been representing me sometime before 1942. I consulted with him about the formation of the partnership around October of 1943. He advised me of the law of partnerships. I do not recall that he specifically advised me that each partner was fully liable for all partnership debts but I think that is common knowledge. I have understood that for a long time. I do not know whether he specifically advised me to form a general partnership as distinguished from a limited partnership, but perhaps he did because we formed a general partnership.

In the fall of 1943, the company was in good shape. It was operating at a profit. It was possible [178] that it might have to liquidate if the court so ordered, but don't see how the company could meet adverse business conditions.

"Q. Mr. Parker, did you testify that the main purpose for entering into a partnership with your children was to provide security for the children?

A. To provide assets of their own, that's correct.

The Court: In other words, at the time the children were small, and they had nothing of their own, and you were not figuring on what they might contribute to the business as, if and when they grew up; isn't that true?

The Witness: Well, my wife and I thought if they had an interest in the business they might become more interested in the business, so that it would grow.

The Court: They were pretty small to bank on that?

The Witness: That's correct. It was just a supposition and hope on our part.

The Court: A hope, that is right. All right."

As of October 31, 1943, the two sons were three and six years old and the two daughters were eleven and fourteen years old.

I did not discuss with Mr. Wilson the matter of general or limited partnerships. I have heard of limited partnerships. I understand that in a limited partnership a limited partner can only lose his capital and cannot lose beyond that, whereas a general partner is liable for all the debts of the partnership, even if the losses of the partnership take all of his capital or even more.

"Q. (By Mr. Machtinger): Did you make the gift to your children conditioned on their paying the tax liability on their portion of the profits of the business?

Mr. Pollock: Objection, your Honor.

The Court: I think that is calling for a conclusion. [179]

Mr. Pollock: The deed of gift speaks for itself.

The Court: What is that?

Mr. Pollock: The deed of gift speaks for itself.

The Court: That is right. I think you may ask him, although I think it has already been answered.

Of course, I asked that question myself: So long as the partnership was a general partnership, the failure of himself would not save the children, no matter how many guardianships he had.

Mr. Machtinger: That is correct, your Honor. I would like to go into whether he had the intent at the time he made the gift, of making the gift only on the condition that the taxes from the business would not be fully taxable to this witness and his wife, but that the children would also pay a tax, and whether, if the children would not pay a tax, he intended not to make the gift.

The Court: I think the way you have it, it is rather a compound question. If you can break it up, and ask him what his intentions were in regard to the taxation, then you come back to that same statement that he made to the court.

Mr. Machtinger: I would like to go into that just for purposes of clarification, your Honor.

The Court: All right, go ahead. Reframe the question. Both of us have been talking, and he will not know which question you want him to answer.

Mr. Machtinger: All right.

The Court: Let me preface it by saying this: You understand a limited partnership has liability only to the extent of the capital investment. If that should be wiped out, it is gone. You understand that?

The Witness: Yes, sir.

The Court: There are other characteristics, but I am simplifying this. A general partnership is

[180] liable for all of the debts of the partnership, or even the loss. If some of your employees in the course of business should run into somebody, and should be sued by Mr. Belli for a half a million dollars for a broken leg, why, you would understand that the partnership would be liable?

The Witness: I understand that.

The Court: You understand that?

The Witness: Yes, sir.

The Court: Then start from there. Go ahead.

Q. (By Mr. Machtinger): Mr. Parker, would you have made the gift to the children if you had realized then that you would have had to pay the tax on their income?

A. When the gift was made to the children, it was made outright. We had hoped the probate court would let the money remain in the business. We had no assurance of it whatever.

Q. Will you answer the question, whether you would have made the gift if you had realized then that the Government would contend that you must pay the tax on their income, as well as your own?

A. I would have made the gift, yes, sir.

Q. You say you have made the gift, even if you were forced to pay all of the tax? A. Yes.

The Court: All right.

The Witness: May I add to that?

The Court: Yes. You see, when you repeat an answer, that is the trouble you get into. He has repeated your answer to the question, so you go ahead.

The Witness: If that was the case, and that

was spelled out at the time, I would have immediately liquidated also. Then they would have had [181] assets free and clear. There wouldn't have been any business to tax.

The Court: I see. In other words, your intention was that they should share in the tax, and later on, then you sought to protect yourself by withholding monies in the partnership, enough to liquidate the claim of the Government if you should have to pay in full; isn't that true?

The Witness: That is true, yes, sir.

The Court: You protected yourself as you went along?

The Witness: Yes, sir.

The Court: All right. I framed the question that way because I don't remember whether those were made right after the additional assessment was levied, or at the time of payment or not. I can't remember the exact dates, but I think you understand my question.

The Witness: Yes, sir.

The Court: All right.

Mr. Machtinger: Are you referring, your Honor, to the compromise claims?

The Court: The various compromise claims, and then through the accounting there are sums of money retained to liquidate.

Then in the petitions before the court there are all sorts of postulates, or what would happen if the Government should win, and what would happen if they should not. Those are the things. I can't stop to pick them out. They appear through

several documents in the earlier time, around the 30 and 31 exhibits.

Mr. Machtinger: I will specifically identify them.

The Court: All right.

Q. (By Mr. Machtinger): Mr. Parker, I show you Plaintiffs' Exhibit No. 26, which is entitled "Application for Authority to Compromise Claims." [182] Will you examine this document, and state whether it is the application for authority to compromise the tax claims asserted against you and your wife for the year 1944?

A. You want me to examine it? I am going to examine all of it, then. I don't want to get just part of it, if you don't mind.

Mr. Machtinger: No, take your time.

The Court: I beg pardon? What did you say?

The Witness: Counsel wanted me to pick out a little piece. He asked me to examine the document. I don't remember back ten years.

The Court: He is bringing you back. Look, he is not trying to catch you in anything. I won't let him. What we are talking about, you know, in these applications is that you set forth certain conditions to protect yourself. I brought that question up myself, and he wants you to merely identify it. You don't have to get down to details.

The Witness: Which parts specifically are you talking about?

Mr. Machtinger: Mr. Parker, I merely wanted you to state whether this is the document by which you and your wife applied for authority to compromise the claims asserted against you and your

wife by the Government for the fiscal year ended October 31, 1944?

Mr. Pollock: We will so stipulate. The document speaks for itself.

Mr. Machtinger: Will you also stipulate that Plaintiffs' Exhibit 34 represents an application for authority to compromise the claim asserted against Mr. and Mrs. Parker for the fiscal years 1945 and 1946?

Mr. Pollock: Where are you reading from?

Yes, we will so stipulate. [183]

Q. (By Mr. Machtinger): And by these documents, Mr. Parker, you requested and the court authorized that an offset statement be signed, by which the refunds due to the guardianship estates for the years 1944, 1945 and 1946 would be credited against the additional tax claimed by the Commissioner as due from you and your wife?

Mr. Pollock: I object, your Honor, on the ground—I know counsel is not intending to do so, but the document, Plaintiffs' Exhibit 26, is an application, and there is no order that was obtained on the basis of it.

Mr. Machtinger: All right. I will then include in that sentence, or in that question: The exhibit by which the court authorized such a payment and offset?

The Court: I think, gentlemen, perhaps it is my own fault. I did not intend to open up a line of inquiry that is merely a question of argument. I merely tried to show you gentlemen, that as you go along, I try to familiarize myself with these

exhibits, and while I may not know them verbatim, I know what is in them. And I referred to them merely to indicate that there is evidence in the record in which he and his wife asserted a claim against the guardianship funds in case they should be required to do that. That is all I intended to bring out.

Mr. Machtinger: Yes, sir. In that connection I was going to bring out not only have they obtained the profit, but they have also retained the right." [184]

I did not borrow any money for the business in 1943, 1944 or 1945. It has always been my policy to have the business expand out of retained earnings rather than through borrowed funds.

At the time of making the gifts in October of 1943, I was acting as the president and general manager of the entire operation of the business, and after making the gifts my duties were the same. After making the gifts I talked over any vital matters with my wife and went to the court for instruction on a number of matters, all of which are in the record. I did not obtain authorizations from the court for decisions in the regular operation of the business. My wife did not work in the business and received no compensation from the business. She spent her time in the running of the household.

I was not present at every guardianship hearing in the Superior Court.

Mr. Wilson was the only attorney who represented me in the guardianship proceedings.

Mr. Wilson is my attorney and prepared all the papers presented to the court in the guardianship proceedings.

Neither my wife or myself ever withdrew any money or assets other than salaries and borrowings from the partnership during the period November 1, 1943 to the end of the partnership in 1948. Mrs. Parker and I gave notes to the partnership for the money borrowed from the partnership in the amount of \$214,000.00.

“Q. (By Mr. Machtinger): Mr. Parker, are you familiar with this document, which is Defendants’ Exhibit A, and which I now show you?

A. Yes, in general. I know the contents of it.

Q. I would like, specifically, to refer your attention to two paragraphs on the back of this [185] document, under the heading “Comments.”

The third part of paragraph 2 reads as follows:

“The father received a salary of but \$12,000, whereas his services were worth at least \$52,000 per year. If a full and fair salary of \$52,000 per year had been paid the father, a result more comparable to that shown in situation C would have obtained.”

Situation C is entitled, “Result if Children Pay All of the Additional Tax.”

Mr. Parker, since you represented to the Superior Court that your services were worth at least \$52,000 per year, would you explain how you represented on direct examination that your reasonable salary was but \$12,000 per year?

Mr. Pollock: Objection, your Honor.

The Court: He didn't say it was reasonable. He merely said he was satisfied.

Mr. Pollock: Our objection, your Honor, is based upon the ground that the witness, as well as the court, should be advised of the fact that this is a document prepared by counsel, about which the witness has testified that he is familiar.

The Court: I assumed that. It is an argumentative question. Nevertheless, there are so many elements in cases of this character that at times the small salary may work both ways. It may indicate expectation of greater remuneration through profit, as I said a while ago, so that I think it is a proper subject of inquiry.

Mr. Pollock: I do, too, and I think that——

The Court: But I don't think the manner in which the question was put is fair to the witness. He hasn't said that. He said he was satisfied. [186]

Mr. Machtinger: I recall one of the questions that counsel framed, and I possibly was wrong, was whether he considered the salary reasonable. Now, apparently,——

The Court: He didn't answer it that way. He said, "I was satisfied." He didn't give the correct answer, whether it was reasonable or not. Regardless of anything contained in the paper, I will let you ask him whether he considered it reasonable under the circumstances, and let him give any explanation he wants to.

Mr. Machtinger: I will withdraw the prior question.

Q. Did you consider your salary of \$12,000 for

the year 1943, 1944 and 1945 reasonable, taking into account the services you rendered to the business? A. Yes, sir.

Q. Why did you draw a salary—why did you represent to the Superior Court that the worth of your services was at least \$52,000 per year?

Mr. Pollock: Objection, pending foundation, your Honor, that that is what Mr. Parker did represent to the court.

The Court: I realize that when arguments are being used by counsel, you do not charge them to a client, but when a representation is made as to what the salary is worth, I assume that the attorney would consult with the client before making such a representation. I will sustain the objection, but I will let you ask him if he knew.

Mr. Machtinger: But, your Honor, the witness testified previously that every document filed in the Superior Court was either filed by Mr. Wilson, or——

The Court: That is all right as a general proposition, but you are coming down to a particular problem at the present time, so I would ask him if he remembers the statement made in the course of this argument, that he could easily have [187] charged \$52,000 a year, and then start from there.

I merely want to be fair to the witness, and not charge him with all that lawyers do. Inferentially he is responsible, but an argument may be made by attorneys without consultation with the client, although I think——

Mr. Pollock: We will stipulate that that was

not the instance here, but we do want a foundation, your Honor.

The Court: I think he ought to be asked, in fairness to the witness. Go ahead.

Q. (By Mr. Machtinger): Mr. Parker, you testified that you were familiar generally with this document. Were you consulted by Mr. Wilson when this document was filed?

A. I believe that the general contents of the document were talked over. The specific amount of \$52,000 wasn't, and when I knew the amount—I got the copy of the document after it was filed—it sounded very flattering.

Q. Did you discuss with Mr. Wilson generally the procedure that you might take in connection with a possible compromise through the Superior Court of the taxes that were then pending against you, in connection with the taxes for the year 1944?

A. Well, we consulted quite a few times, I believe.

Q. Did you confer with him as to the application for compromise of tax claims for the year 1944, that was filed in the Superior Court guardianship proceedings?

A. I believe it was talked over, yes, sir.

Q. Was not this document filed in association with that application?

Mr. Pollock: Objection. The file will speak for itself.

The Court: It is stipulated that it is a memorandum in conjunction with it. [188]

Mr. Machtinger: The memorandum, your Honor, is entitled, "In re Incidence of Federal Income Tax Liability on 1944 Partnership Income."

The Court: Does it show any filing date in the Superior Court?

Mr. Machtinger: It shows a filing date of September 16, 1946.

The Court: All right. What is the date of the petition?

Mr. Machtinger: The date of the petition is August 27, 1946.

The Court: The two are related. I presume internal evidence would show that it is an argument filed in conjunction with the application.

Q. (By Mr. Machtinger): Did you request Mr. Wilson to file any document or paper in the Superior Court which would have the effect of either withdrawing this allegation that your salary was worth at least \$52,000, or repudiating that statement? A. No, it never come up.

The Court: I didn't quite catch the word that you used before. What word did you use when you told us—flattering? Was that the word you used?

The Witness: Yes, sir.

The Court: What did you mean,—that it was selling yourself rather high? Is that it?

The Witness: Well, yes, taking a figure out of the air.

The Court: I see. All right.

Q. (By Mr. Machtinger): Mr. Parker, there is

a further statement in this memorandum, which reads, as follows:

“The parents furnished all of the capital, [189] do all the work and support the children, so should be taken care of first.”

Was that an additional basis which you relied upon for the request to the Superior Court to grant the application for compromise of claims?

Mr. Pollock: Objection, your Honor.

The Court: I will sustain the objection. Unless the witness here repudiates or modified the statement, such as the one specifically relating to the salary, it will be assumed that he is chargeable with all of the reasons and grounds that were alleged in the course of the proceedings in the various petitions, other than pure legal argument.

When it related to facts, he is charged with the argument that was used, and you can take it as a fact, unless there is repudiation, and you can draw whatever inference you desire in your argument, but you are arguing with the witness too much.

I did not mind the question on the particular salary, because that is something specific, but to put out every one of the items and discuss with him the question of whether he approved or not is not necessary.

Mr. Machtinger: Yes, sir.” [190]

At the time we made the gifts to the children on October 31, 1943, the children did not have any other assets. They have not since acquired any

assets by inheritance. They have not earned any money outside the business.

If I had known in 1943 that my wife and I would have been taxed on the children's income if we made gifts to them, I would have done it anyway as I thought the income would remain at a normal level such as it had been in the past. At that time I couldn't tell whether the business would continue to expand; I just hoped that it would go along in a normal manner.

After my wife and I were discharged from bankruptcy, I acquired the water heater manufacturing business by a gift from a relative and the rendering of services and the paying of cash out of services and earnings.

After the gifts were made the operations of the company did not change. The profits continued to increase, through 1946. [191]

Redirect Examination

Prior to the bankruptcy, I was engaged in real estate activities and in the heater business. The heater business always showed a profit, but I lost a lot of money in the real estate business.

My salary of \$12,000.00 per year that I got from November 1, 1943 to April 30, 1946, seemed reasonable to me because it was more than anyone else in the business was drawing and it was as much as I have ever drawn in my life before. The salary seemed reasonable to me in November 1943 and I had no reason to know that the business would grow rapidly. When it did, my salary was

never increased. I had received \$12,000.00 a year in the partnership in which my wife and I were partners.

The partnership in which the children were interested paid a salary of \$6,000.00 to the sales manager and he also drew a bonus of \$1,000.00 or \$2,000.00 a year. His name is Mr. McGaughey. Mrs. Fierke, the controller, drew a salary of \$4,000.00 to \$5,000.00 and she drew a bonus.

Most of the earnings of the business except for the amount necessary for each partner to pay income taxes were retained in the business except that there was distributed to each guardianship \$3,750.00 which was used to buy Government bonds.

Each guardianship had a separate bank account. The children's shares of undistributed earnings were credited to their capital accounts on the partnership books.

Recross Examination

By Mr. Machtinger:

The disbursements from guardianship funds other than income taxes for the period November 1, 1943 to October 31, 1948, as shown by Exhibit 60, was taken from the books and is correct. Other than those disbursements from the guardianship [192] funds, all of the partnership cash remained in the partnership bank account.

CAPITOLA FIERKE

called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

My name is Capitola Fierke. I live at 9516 South

Horley Avenue, Downey, California. I am the office manager for the Southern Heater Corporation. I have been associated with my employer and its predecessor since 1937, including the period 1943 to 1948, doing the same type of work. I was called a bookkeeper for a long time and office manager and sometimes called controller. I kept the books. I figured the invoices, posted the books and made statements. I was familiar with the books of the Southern Heater Company.

In the latter part of 1943 I was told that Mr. and Mrs. Parker were bringing the children into the partnership. Mr. Parker told me. He asked me to set up the books showing the children as partners, showing that each owned an eighth interest and Mr. Parker had a quarter and Mrs. Parker had a quarter interest. Thereafter the books continued to reflect those partnership interests. I knew that guardianships existed for the four minor children. I knew that almost from the beginning. Mr. Parker also told me about the guardianships.

ARTHUR ELGIN PARKER

called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

My name is Arthur Elgin Parker. I am the son of Elgin R. Parker and Flo Parker, the plaintiffs in this case. I live at 120 South Burris, Compton, California. I live with my mother and father, my brother Rowland and my young sister Nancy.

I am 15 years of age. I am a sophomore at Compton High School. I believe I would like to take an

engineering course at Stanford University. I am [193] taking four years of math in high school.

I have worked in my family's heater manufacturing business for the last three summers and before that on odd occasions. During the last three summers I worked eight hours a day for six to eight weeks each summer. I did maintenance jobs; I worked on the assembly line; I helped in the office. Most of my work was on maintenance jobs. I liked working in the office best after I learned what was done out at the plant. In the office I worked at various things which helped me to learn about the business.

After I finish my formal education, at the moment, I think I would like to go into the family business. I have so told my father but have also told him that that was still something that may change since that was a long way off. I think that an engineering degree would be helpful to me if I went into the business. I have been thinking along that line for about a year and a half.

About two years ago I first learned that gifts had been made to me by my father and mother. My father told me. He told me that he had made gifts of an interest in the business to me to create an interest in me about the business. I think my father would like me to go into the business but he wants me to make my own decision whether to go into it or not.

Cross Examination

By Mr. Robert H. Wyshak, Assistant United States Attorney:

I know that my father and mother owe me some money but I do not know the amount. I do not know if I have directly or indirectly received any interest on the loan.

I have never filed a gift tax return. I have never discussed with my father as to how much interest I was going to charge him on the money he owed me. [194]

ROWLAND TIBBETTS PARKER

called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

My name is Rowland Tibbetts Parker. I am the son of Elgin R. Parker and Flo Parker, the plaintiffs in this case. I live at 120 South Burris Avenue, Compton, California. I live with my parents, my younger brother and my younger sister. I am 19 years of age and a freshman at the University of Southern California.

I am taking business administration at the university. I have not made any definite plans yet as what I will do when I leave college. Tentatively I have decided to do one of two things. I will either enter into a career of designing clothes or enter into the family business.

I have worked in the family business of Southern Heater Corporation and its predecessors since I was about five years of age. I worked at first on Saturdays without compensation and then during the past five summers I have done maintenance and office work for the company. I have done the same type of work on vacations also. This work

was a full eight hours a day, not less than eight weeks each summer.

I worked on the assembly line, in the office, painting and other maintenance jobs. I think I worked at practically all the phases of the business. I think that I was moved around in different types of work so that I could get some knowledge of all phases of the business.

About three years ago, my father told me that he and my mother had given me a one-eighth interest in the business. My father said that they had made the gifts for two reasons: One to set up security so that if something should happen we children would have something. Also to give us an interest in the family business, perhaps later to go in and make it our profession. The knowledge that I had an interest in the business gave me a [195] feeling of obligation to my family, my sisters and brother, to help look after the business.

My business administration course covers a general background of law and accounting, office management, plant management, sales, etc. It should enable one to handle any phase of the business.

About three years ago I also learned that my father had been appointed the guardian to handle the interests that were given to my sisters, my brother and myself.

Cross Examination

By Mr. Wyshak:

I never discussed with my father the rate of interest I would charge him on the money he owed me. I never filed a gift tax return.

ELEANOR FLO PARKER

called as a witness on behalf of the plaintiffs, having been first duly sworn, testified as follows:

My name is Eleanor Flo Parker and I am one of the plaintiffs in these actions and I am the wife of Elgin R. Parker. My occupation is that of housewife. I have not had any other occupation since around 1940, nor since I have been married.

I am familiar with the Southern Heater Company, a sole proprietorship which once was operated by my husband. I know that a partnership was entered into between my husband and myself in 1942, and I had a fifty per cent interest and he had a fifty per cent interest and that lasted a year.

I also know that in 1943 a new partnership was created in which my husband and myself and my four oldest children were partners. Mr. Parker had a 25 per cent, I had a 25 per cent, and each of the children had an eighth interest. The children's interests were acquired by them by deeds of gifts from Mr. Parker and myself. [196]

During the period 1942 to 1943 in which my husband and I were partners I was not active in the business. I did not participate in any of the management decisions or any of the other decisions with regard to the operation of the business. Mr. Parker discussed things with me and then he made the decisions. I would say that I was generally informed about the nature and scope of the business in which I held a fifty per cent interest, but I did not work there nor draw any salary.

I discussed with my husband, but not with any-

one else, the matter of making gifts to our children. We discussed this on many occasions, starting in 1940 when we were coming back from Alabama. We thought we ought to give the children some security, and the discussions went on from there. Mr. Parker and I discussed this matter from 1940 on until the decision had been made, and we never disagreed about the making of the gifts.

Our purpose was to help them financially and to interest them in carrying on their father's business.

Prior to making the decision to make gifts to the children, I did not discuss this matter with anyone other than Mr. Parker, not with any attorney, accountant or any other professional man. I was not aware that there would be any income tax consequences from the making of these gifts nor did I know there would be any gift tax consequences.

I knew in 1943 that guardianships were created in which my husband was appointed guardian for the four older children.

I think it would be a very fine thing if the boys would carry on with the business, but if they are inclined to do something else, I think they should go into the business they choose.

Our youngest child, Nancy Susan, is ten years [197] old and we have made some gifts of real estate to her in trust. My two oldest daughters are the trustees.

CONDENSATION OF OTHER EVIDENCE

The complaints allege and the answers admit certain facts.

During the trial the parties entered into oral stipulations as follows:

1. That the copies of the exhibits which were filed in the guardianship proceedings in which the four Parker children were wards and Elgin R. Parker was the guardian, are correct copies and may be introduced in evidence without further corroboration. It was also stipulated that the copies of other documents filed in Governmental offices may be introduced in evidence without further proof of their authenticity and that said copies offered by the plaintiff are true copies.

2. That so far as outside persons were concerned, no opposition was ever made or entered into formally or informally to any of the applications in the guardianship proceedings, excepting objections, or questions or conditions imposed by the surety company or by the court itself.

The plaintiffs introduced into evidence Exhibits 1 to 64G, inclusive, which are set out herein in full as indicated or digested and numbered as follows:

1. Elgin R. Parker's Deed of Gift to the four children dated October 31, 1943, set out in full.

[See page 117.]

2. Flo Parker's Deed of Gift to the four children which is identical to Exhibit No. 1, except the name of the grantor.

3. Articles of Co-Partnership entered into as of November 1, 1943, and notarized February 25, 1944, set out in full. [See page 121.] [198]

4. California Sales Tax Permit. The new partnership, consisting of the plaintiffs and the four

children received a California Sales Tax Seller's Permit under the name of Southern Heater Company showing the initials of the six partners, dated November 1, 1943.

5. Employer's Number. This consisted of a notice to the new partnership, consisting of the plaintiffs and the four children, of the Employer's Identification Number under Chapter IX of the Internal Revenue Code, known as "Employer's Number."

6. Certificate of Fictitious Firm Name, dated

This exhibit shows that a new partnership filed a certificate of fictitious firm name for Southern Heater Company and that said certificate was duly published and filed in accordance with the law.

7. Amendment of Articles of Co-Partnership, dated July 7, 1945. This was the first amendment to the partnership agreement. It simply provided that the salary which Elgin R. Parker was to receive from the partnership was to be the community property of himself and wife.

8. Second Amendment to Articles of Co-Partnership.

This second amendment to the partnership agreement, dated May 24, 1946, recited that since the partnership had transferred its active businesses to two corporations in exchange for their stocks, and now that this partnership merely held the stocks and the real estate, the salary of Elgin R. Parker provided for in the original agreement was reduced to \$200.00 per month, this salary to be paid by the partnership.

9. Notice of Dissolution of Partnership. The Notice of Dissolution of the partnership as [199] of November 1, 1948 was published in March 1949 in the Los Angeles Daily Journal as shown by the verified report of the publishing company.

10. Agreement for Dissolution of Partnership, dated November 30, 1948, with balance sheet attached, set out in full. [See page 130.]

11. Petition for Appointment of Guardian, dated November 1, 1943, filed December 1943, signed by Elgin R. Parker. This petition requested that Elgin R. Parker be appointed guardian of the estates of his four above-named children stating their ages at 14, 11, 6 and 3 years respectively; that each child owns a $12\frac{1}{2}\%$ interest in and to the partnership of Southern Heater Company and in and to the assets owned by said partnership. The real estate was described as were the other assets and liabilities by Exhibit A attached. The petition stated that the value of the personal property of each minor was \$19,648.18 and the value of the real estate of each minor was \$7,214.23 and the probable annual income was \$3,000.00 for each minor. The mother, Flo Parker, approved the appointment of her husband, Elgin R. Parker, and Flo Dian Parker, who was 14 years of age, nominated and requested the appointment of her father, Elgin R. Parker, as guardian of her estate.

12. Order Appointing Guardian. On February 7, 1944, the court appointed Elgin R. Parker as guardian for the estates of the four children, con-

ditioned on his getting a surety bond for \$23,000.00 for each guardianship estate.

13. Application for Instructions on Investment, filed February 7, 1944, by Elgin R. Parker as guardian. Set out in full. [See page 133.] [200]

14. Order Instructing Guardian on Investment of Guardianship Funds filed February 7, 1944. The order authorized the guardian to act, as prayed in Exhibit No. 13, above.

15. Letters of Guardianship. The letters show that Elgin R. Parker was appointed guardian for the estates of four children and he took oath of office on December 31, 1943.

16. Petition for Instruction on Signing a Partnership Agreement, filed March 1, 1944. A copy of the proposed partnership agreement, approved by the guardian, was filed in court and the guardian requested the court for authority and instructions to sign as guardian, the partnership agreement.

17. Order for Instructions on Signing a Partnership Agreement, filed March 1, 1944. The court authorized and instructed the guardian to sign the partnership agreement presented, and approved the form of the partnership agreement and the salary of \$12,000.00 a year to be paid to Elgin R. Parker from the partnership.

18. First Annual Account of Guardian filed May 3, 1945. Attached to the first annual account was a report of the activities of Southern Heater Company for the year ended October 31, 1944 made by Meyer Pritkin & Company, Certified Public Accountants. The account showed an opening balance

for each estate of \$24,745.98 and a closing balance, after adding income and deducting withdrawals, of \$41,385.45 for each guardianship estate.

19. Notice of Hearing of First Annual Account of Guardian.

20. Decree Settling First Annual Account of Guardian, filed May 18, 1945. The decree approved the first annual account.

21. Second Annual Account of Guardian, filed January 19, 1946.

22. Decree Settling Second Annual Account of Guardian, filed February 1, 1946.

23. Application for Instruction on Investment of Funds of Wards, filed February 5, 1946. The application recited that each guardianship estate had an eighth interest in the partnership known as Southern Heater Company and each interest had a book value of \$54,417.94. In addition, each guardianship estate had Series E Bonds costing \$3,750.00 making a total for each estate of \$58,167.94.

The application requested authority for the guardian to cause the partnership, Southern Heater Company, to transfer personal property, such as machinery and equipment, inventory and cash, etc., to a corporation about to be formed to be known as Southern Heater Corporation. The cost of the assets to be transferred was \$304,000.00 and the partnership was to receive from Southern Heater Corporation all of its outstanding stock of the par value of \$304,000.00. Said corporation would carry on the business of manufacturing and selling of water heaters and other household appliances. It

would lease from the partnership such land and buildings as it needed and would employ as officers, Elgin R. Parker, his wife, and other employees of the partnership.

The application also requested authority to transfer from the partnership personal property having a cost of \$48,000.00 to a corporation about to be formed called the American Control Corporation, which would issue all of its outstanding stock of [202] a par value of \$48,000.00 to the partnership. This corporation would manufacture and build automatic controls and brass specialties and its officers and directors would also be Elgin R. Parker and his wife and other employees of the partnership.

The application recited various business reasons for the proposed incorporation of the manufacturing phases of the partnership business.

24. Order Dispensing with Notice of Hearing on Application for Instruction of Investment of Funds of Wards.

25. Order Instructing Guardian on Investment of Funds of Wards, filed February 5, 1946. The court issued its order instructing the guardian to transact the matters covered in the application, described in Exhibit No. 23.

26. Application for Authority to Compromise Claim, filed August 27, 1946, set out in full. [See page 138.]

27. Notice of Hearing on Application for Authority to Compromise Claim.

28. Application for Authority to Compromise

Claim, dated April 11, 1947, set out in full. [See page 143.]

29. Third Annual Account of Guardian, filed April 11, 1947. This account records the activities of the partnership and of the guardian for the year ended October 31, 1946. It asked that the account be approved, except that the pending claims of Elgin R. Parker and Flo Parker, for adjustment on account of income taxes which had not been acted upon by the Superior Court.

30. Decree on Third Annual Account, filed April 25, 1947. The decree approved the third annual account.

31. Order for Authority to Compromise Claim, dated April 25, 1947, set out in full. [See page 146.]

32. Fourth Annual Account, Application to Compromise Claim and to Invest Funds of Ward, filed July 16, 1948. The account showed the operation of the partnership and of the guardianship estates to March 31, 1948.

The guardian also asked authority of the court to use federal income tax refunds payable to the children for 1945 and 1946 in the same manner and under the same terms as was set forth in plaintiff's Exhibits No. 28 and No. 31 for the taxable year 1944.

The account also requested authority of the court to transfer the real estate owned by the partnership costing \$58,000.00 to a corporation, about to be formed, to be known as the Parker Realty Corporation, in consideration of issuing to the partnership all the outstanding stock of the corpora-

tion of the par value of \$58,000.00, and stated that the officers of the corporation would be Elgin R. Parker and his wife and sister who was an employee of the partnership.

The application stated that it was believed to be for the best interests of the guardianship estates to have the property owned by a corporation, as such ownership would prevent the title to the property being an undivided interest to several persons, such as might be the case if some of the wards attained majority or married and died leaving a spouse or issue. If interests in the property fell into hands of persons with divergent views than the other owners of the interests, it would reduce the value of each interest.

33. Notice of Hearing on Fourth Annual Account, Application to Compromise Claims and to Invest Funds of Wards. [204]

34. Order Settling Fourth Annual Account, Application to Compromise Claims and to Invest Funds of Wards, filed July 30, 1948, set out in full. [See page 148.]

35. Fifth Annual Account of Guardian, filed November 15, 1948.

This account stated that four claims had been presented against the guardianship estates and had not been settled except on a tentative basis.

It showed that each guardianship estate had a $12\frac{1}{2}\%$ interest in the partnership known as Southern Heater Company, having a value of \$84,589.92 and Series E Bonds having a cost of \$3,750.00 or a total for each estate of \$88,339.92.

The operating statement of the partnership for the period April 1, 1948 to October 31, 1948 was shown as well as an analysis of the partnership's capital and the balance sheet of October 31, 1948.

The account showed that the partnership, as of October 31, 1948, owned practically nothing except the stock of four corporations; namely Southern Heater Corporation, American Control Corporation, The Parker Realty Company and Radiantair, Inc., and 4½% notes signed by Elgin R. Parker and Flo Parker payable to the partnership. It stated that the notes of Elgin R. Parker and Flo Parker owned by the partnership were given to the partnership to represent their obligations to repay excessive withdrawals made by Elgin R. Parker and Flo Parker to enable said persons to pay their income taxes. The account said:

"If the said parties win their income tax cases, they can pay the notes out of their income tax [205] refunds. In the event they lose the income tax cases, they will seek further adjustment, with the approval of this court, against the guardian-ship estates on account of income tax matters."

The report said that inasmuch as all the activities of the partnership had been reduced to the mere holding of stocks in the corporations, it was believed that it would be to the best interests of the partners and the guardianship estates that the partnership be dissolved and the stocks and notes distributed to the partners who would hold them directly or through their guardian.

The report prayed for approval of the account,

showing the unsettled claims against each guardianship estate filed by Elgin R. Parker and Flo Parker for adjustment on account of income taxes; that dissolution of the partnership be approved, and asked that distribution of its assets directly to the partners or to the guardianship estate be authorized.

36. Order Settling Fifth Account of Guardian, filed December 7, 1948. The court approved the requests made in the fifth annual account.

37. Application for Instructions on Investment of Funds of Ward, filed March 24, 1950. Application stated that Elgin R. Parker was guardian of the estate of Flo Dian Parker, that she was now married and was Mrs. Frank McDaniel and was the mother of a child and wanted to purchase Lot 22, Block 2 of Belle Vernon Acres Tract, also known as 436 Sixth Street, Compton, California, out of her guardianship funds, for \$1,800.00, plus buyer's share of the escrow costs. [206]

38. Order Instructing Investment of Funds of Ward. On April 14, 1950, the decree was made instructing the guardian on investment of funds of ward as prayed for in Exhibit No. 37.

39. Sixth Annual Account of Guardian, Final Account, Report and Petition for Distribution of the Guardianship of Flo Dian Parker, Application for Authority to Compromise Claim, Petition for Allowance of Attorneys' Fees, dated September 6, 1950. Set out in full with Exhibits A and B attached. [See page 153.]

40. Decree dated September 25, 1950 Settling Sixth Annual Account of Guardian, Settling Final

Account, Report and Petition for Distribution of the Guardianship of Flo Dian Parker, Decree Authorizing Compromise of Claim and Ordering Payment of Attorneys' Fees. Decree allowed all the matters prayed for in Exhibit No. 39 and approved the sixth annual account.

41. Seventh Annual Account, Petition for Discharge of Guardian with Respect to Flo Dian Parker, Petition for Payment of Attorneys' Fees, filed October 26, 1951.

This account stated that the claims as filed by Elgin R. Parker and Flo Parker against the guardianship estates had been compromised as shown by the decree entered on September 25, 1950, but that since the income tax litigation involving the guardianship estates had not been completely settled, the statement of the account on the settlement of the claims could not be completed.

The seventh annual account provided for the discharge of Elgin R. Parker as guardian for Flo Dian Parker. The account showed that the guardian had turned over to Flo Dian Parker [207] McDaniel assets costing \$51,165.13 and that a receipt of Flo Dian Parker McDaniel for such assets had been filed in the guardianship account.

The account showed that the guardian was holding further assets having a cost of \$38,565.25 which was being kept by the guardian on the conditions and under the terms of the decree settling the final account, report of petitioner for distribution of the guardianship of Flo Dian Parker, filed September 25, 1950, being Exhibit No. 40 herein.

The seventh annual account showed an opening balance of \$90,056.78, income received of \$10,259.96, disbursements of \$3,038.07 and a balance chargeable to the next account of \$97,261.01 for each guardianship estate.

Exhibit A attached to said seventh annual account showed each guardianship estate received income as follows:

Dividends, Southern Heater Corporation	\$ 5,250.00
Dividends, American Control Corporation	4,950.00
Interest, Compton Commercial Savings Bank	60.64

Total	\$10,260.64
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The seventh annual account showed each guardianship estate had disbursements as follows:

Guardian Bond Premium	\$ 89.25
Legal Fees in Connection with the Guardianships	100.00
Payment on Estimated 1950 Income Tax	2,705.38
Guardian Bond Premium—1951	89.25

Total Disbursements	\$2,983.88
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42. Decree Approving Seventh Annual Account, Petition for Discharge of Guardian with Respect [208] to Flo Dian Parker, Petition for Payment of Attorneys' Fees. This decree entered November 9, 1951, approved the seventh annual account and petition set out in Exhibit No. 41 above.

43. Receipt of Flo Dian Parker McDaniel for the assets received from the guardian having a cost of \$51,165.13. This was filed November 1, 1950.

44. Eighth Annual Account of Guardian and Petition for Allowance of Attorneys' Fees. This account was filed October 6, 1952 and refers to the fact that the settlement of the claims which were compromised by the decree on September 25, 1950

had not been completely consummated as the income tax litigation was still pending.

The petition also showed that the guardianship of Flo Dian Parker had been discharged, the discharge having been entered on November 9, 1951.

The account showed for each guardianship as follows:

Balance chargeable from Seventh Account	\$ 97,261.01
Income for the period 8/1/51 to 7/31/52	7,890.19
	<hr/>
Total	\$105,151.20
Disbursements	1,363.54
	<hr/>
Balance chargeable to next Account	\$103,787.66

The account also showed that Patricia Lee Parker was married and her name was now Patricia Lee Parker Brown.

Exhibit A attached to eighth annual account showed that each guardianship estate received income as follows: [209]

Dividends, Southern Heater Corporation	\$4,375.00
Dividends, American Control Corporation	3,250.00
Interest Compton Commercial Savings Bank	266.11
	<hr/>
Total Income	\$7,891.11

Each guardianship estate had disbursements as follows:

Attorneys' Fees	\$ 37.50
Payment on Estimated 1951 Income Tax	1,200.00
Guardian Bond Premium—1952	87.15
Balance of 1951 Income Tax	129.64
	<hr/>
Total Disbursements	\$1,454.29

The eighth annual account showed that each guardianship estate had assets at July 31, 1952 as follows:

Cash in Compton Commercial Savings Bank	\$ 17,581.99
Accounts Receivable—Employees of Southern Heater Company	9.64
Notes Receivable—E. R. Parker and Flo Parker ..	26,841.31
1,050 Shares of Southern Heater Corporation Stock at Cost	42,527.84
195 Shares of American Control Corporation Stock at Cost	6,500.00
217½ Shares of Parker Realty Company Stock at Cost	7,250.00
Series E Bonds	3,768.75
Loans Payable Southern Heater Corporation	(89.25)
Customers Credit Balance (carried over from Southern Heater Company dissolved)	(602.62)
Total	\$103,787.66

45. Decree Settling Eighth Annual Account in all respects, dated October 17, 1952.

46. Petition for Authority to Execute Deed, dated December 10, 1952. This petition requested authority for guardian to execute without [210] consideration a deed on behalf of the three remaining wards for the real property which had been owned by the partnership and previously deeded to Parker Realty Company.

The petition stated that the Parker Realty Company wishes to revert the property's acreage for purposes of constructing a building of their own which covered more than one of the lots, and the Title Insurance & Trust Company advised that a deed covering said property could be executed by the guardian in the above entitled proceedings to the Parker Realty Company pursuant to an order of court. It had appeared from the Title Insurance & Trust Company's letter that the partners had not

transferred title to the property to the partnership and this deed from the partners was necessary.

47. Order for Authority to Execute Deed. The order authorized the executor to execute the deed mentioned in Exhibit No. 46.

48. Application for Instruction on Investment of Funds of Wards and for Leasing of Property, dated June 15, 1953.

The application requested authority for the guardian to purchase for the three guardianship estates, two acres of ground located at 17,915 South Figueroa Street, Los Angeles, California, improved with a new cement plant building which was constructed for an office building.

The application stated that the guardian had negotiated with the owner of the property to purchase it, subject to the approval of the court, for \$34,000.00 and had also negotiated to lease it for a period of ten years at \$4,500.00 per year, plus insurance, repairs and taxes.

49. Order Instructing Guardian on Investment of [211] Funds and Leasing of Property. The court made an order authorizing the guardian to make the investment and the lease covered in Exhibit No. 48. (Such investment and leasing were not made, as by the time the order had been obtained, the owner had sold the property to others.)

50. Ninth Annual Account of Guardian, Final Account, Report and Petition for Distribution in the Guardianship of Patricia Lee Parker, Petition for Allowance of Attorneys' Fees, dated October 25, 1953.

This account showed that the income tax claims filed against the guardianship estates by the plaintiffs on account of adjustment of income taxes had not been settled.

The account showed an opening balance for each of the three guardianships of \$103,787.66, income for the period July 31, 1952 to July 31, 1953, of \$7,375.00, disbursements \$1,129.53, and a balance chargeable to the next account of \$110,010.88.

The final account, report and petition for distribution and discharge of guardian with respect to the guardianship of Patricia Lee Parker showed that she was over 18 years of age and had been married; her name was now Patricia Lee Parker Brown. Petition asked for permission to distribute to Patricia Lee Parker Brown, assets costing \$64,286.25 and to hold in a reserve for the compromise of said claims on account of income taxes and payment of \$200.00 attorneys' fees, assets costing \$45,724.63, which amount would be withheld until the outcome of the federal income tax litigation. This account stated that if the litigants were successful in this case, Patricia Lee Parker Brown would receive an additional \$45,524.63, plus additional interest. [212]

The account showed that the income for each guardianship estate for that period was as follows:

Dividends, Southern Heater Corporation	\$4,375.00
Dividends, American Control Corporation	2,600.00
Interest on Savings Account—Compton	
Commercial Savings Bank	358.95
Total	<u>\$7,333.95</u>

The account also showed disbursements as follows:

Attorneys' Fees	\$ 50.00
Payment on Estimated 1952 Federal Income Tax	700.00
Balance of 1952 Federal Income Tax	76.00
California income tax	20.19
Payment on estimated 1953 Federal Income Tax	75.00
Guardian Bond premium	92.17
Total	<u>\$1,013.36</u>

The account showed that there was held for Arthur E. Parker the following assets on July 31, 1953:

Cash	\$ 23,924.00
Account Receivable, Employees of Southern Heater Company	9.65
Notes Receivable, E. R. Parker and Flo Parker	26,841.31
700 Shares Southern Heater Corporation Stock at Cost	42,527.84
130 Shares American Control Corporation Stock at Cost	6,500.00
145 Shares Parker Realty Company Stock at Cost	7,260.00
U. S. Government E Bonds	3,768.75
Loan Payable Southern Heater Corporation	(89.25)
Customers Credit Balance (carried over from Southern Heater Company dissolved)	(602.62)
Total	<u>\$110,139.68</u>

A similar amount was held by Rowland T. Parker.

51. Decree Settling Ninth Annual Account of Guardian, and Settling Final Account and Report of Petition for Distribution for Guardianship of Patricia Lee Parker Brown and Order for Payment of Attorneys' Fees, dated November 13, 1953. The court approved the ninth annual account, etc., as requested in Exhibit No. 50.

52. Application for Instruction on Investment of Funds of Wards, dated May 24, 1954.

This application asked for authority to invest on behalf of each of the two remaining guardianship estates, 75 shares (at a cost of \$7,500.00) of common capital stock of D. P. Ran Appliance Corporation, and \$7,500.00 in the 5% unsecured notes of that corporation due in five years.

This application stated that the D. P. Ran Appliance Corporation was about to be formed and would be owned by the five Parker children through their guardianships, trust, or directly, and Gilbert G. McGaughey, Theodore Thiele, Capitola Fierke.

The application stated that Gilbert G. McGaughey, Theodore Thiele, and Capitola Fierke had long been connected with the Parker companies and were greatly [214] experienced in the manufacture of water heaters and space heaters.

The application stated that the new corporation would lease space from Flo Dian Parker McDaniel at \$750.00 a month, on a month to month basis, until a one-year lease at that rental could be executed with yearly option to renew for an additional four years at the same rental. The new corporation would purchase equipment to set up a plant at said space, to buy raw material and make an initial inventory of furnaces. It was expected that the new corporation would sell space heating furnaces through commission salesmen throughout the country. The application stated that it was believed that the new corporation had an excellent chance

of success due to the experience and contacts of its officers and stockholders.

The application suggested that the investments would be reasonable considering the size of the guardianship estates, the income of each guardianship estate, and the fact that the business of the new corporation would closely approach that of the existing successful corporations in which said guardianship estates held stock.

53. Order Authorizing Investment of Funds of Wards, dated June 11, 1954. The order authorized the guardian to make the investments prayed for in Exhibit No. 52.

54. Tenth Annual Account of Guardian, Application for Discharge of Guardian for Patricia Lee Parker Brown and Petition for Allowance of Attorneys' Fees, dated September 13, 1954.

The tenth annual account stated that the claims against the guardianship estates filed by the parents had not been settled.

The account showed that on November 13, 1954, the [215] court had entered a decree settling the final account, report, petition for distribution of the guardianship of Patricia Lee Parker, now Patricia Lee Parker Brown. It showed that the guardian had the receipt of Patricia Lee Parker Brown for assets costing \$64,286.25 and was holding assets costing \$45,524.63 as a reserve against the claims filed by the plaintiffs on account of income tax.

The application asked for discharge of Elgin R. Parker as guardian of Patricia Lee Parker Brown.

The tenth annual account showed that in each guardianship estate there was on hand at the beginning of the period, \$110,148.44, income for the year was \$6,821.90, and the disbursements for the year \$1,741.22, and the balance on hand at the end of the year was \$115,229.12.

The income for the year was made up as follows:

Dividends Southern Heater Corporation	\$ 8,750.00
Dividends American Control Corporation	3,900.00
Interest Savings Account Home Bank of Compton	993.80
Total	\$13,643.80

The tenth account showed that these bills and disbursements for each account as follows:

1953 Federal Estimated Income Tax	\$2,800.00
Attorneys' Fees	200.00
Guardianship Bond Premium	194.00
Balance of 1953 Federal Income Tax	83.72
1953 California Income Tax	104.72
1954 Federal Estimated Income Tax	100.00
Total Disbursements	\$3,482.44

55. Decree Settling Tenth Annual Account of Guardian, Decree Discharging Elgin R. Parker as Guardian for Patricia Lee Parker Brown, and Order for Payment of Attorneys' Fees, dated October 1, 1954. The decree approved the matters set [216] out in Exhibit No. 54.

56. Eleventh Annual Account of Guardian and Petition for Allowance of Attorneys' Fees, dated August 31, 1955.

The account showed that the claims filed by the

parents against the guardianship on account of adjustment of income tax had not been settled.

The account showed that the guardian was holding in a reserve account, assets contingently belonging to Flo Dian Parker McDaniel, costing \$38,526.25, plus accumulating interest, and assets contingently belonging to Patricia Lee Parker Brown, costing \$45,524.63.

The account showed that for each remaining guardianship estate the balance chargeable from the tenth annual account was \$115,229.12; the income for the year was \$9,661.60, and the disbursements for the year were \$2,259.12, and the balance on hand at the end of the year was \$122,631.60.

The account showed that the income for each guardianship estate for the year was as follows:

Gifts from Elgin R. Parker	\$3,000.00
Savings Account Home Bank—Compton	336.60
Dividends Southern Heater Corporation	4,375.00
Dividends American Control Corporation	1,950.00
Total	\$9,661.60

The account showed the disbursements for each account for the year as follows:

1954 Federal Estimated Income Tax	\$ 925.00
Attorneys' Fees	117.17
Guardian Bond Premium	97.00
Balance 1954 Federal Income Tax	97.64
1954 California Income Tax	42.83
1955 Federal Estimated Income Tax	293.16
1955 Federal Estimated Tax	586.32
Total Disbursements	\$2,159.12

The account showed assets in each account with costs as follows:

Cash	\$ 21,407.16
Account Receivable, Employees of Southern Heater Company	9.65
Notes Receivable, E. R. Parker and Flo Parker	26,841.31
Notes Receivable, D. P. Ran Appliance Corporation	7,500.00
700 Shares of Stock of Southern Heater Corporation	42,527.85
130 Shares Stock American Control Corporation	6,500.00
145 Shares Stock Parker Realty Company	7,250.00
150 Shares Stock D. P. Ran Appliance Corporation	7,500.00
U. S. Government Bond—Series E	2,768.75
Loan Payable Southern Heater Corporation	(89.25)
Customers Credit Balance (carried over from Southern Heater Company dissolved)	(602.62)
 Total	 \$122,612.85
Total Guardianship Funds, July 31, 1955	\$122,612.85

57. Decree Settling Eleventh Annual Account of Guardian and Petition for Allowance of Attorneys' Fees, dated September 16, 1954. This decree approved the matters set out in Exhibit No. 56. [218]

58. Balance sheet as of October 31, 1943, and audit reports for 1944 to 1948.

Set out in full the balance sheet as of October 31, 1943. [See pages 163-4.]

The audit reports for 1944 to 1948 were made by Meyer Pritkin & Company, Certified Public Accountants, of the activities of Southern Heater Company for each of the years mentioned. These reports were attached to the annual accounts and

reports filed with the Probate Court in the guardianship estates.

59. Guardian's Bond. The guardian filed on behalf of each guardianship estate, a \$23,000.00 bond as required by the Probate Court. This was a corporate surety company bond.

60. Analysis of partners' capital accounts, 1944 to 1948, inclusive, including a schedule of disbursements in the guardianships' funds and analysis of the net assets. Set out in full as follows:

1. Analysis of partners' capital accounts, November 1, 1943 to October 31, 1948.

2. Disbursements from guardianship funds other than income taxes, November 1, 1943 to October 31, 1948.

3. Analysis of distribution of net assets on dissolution as of October 31, 1948. [See pages 165-167.]

61. Exhibits No. 61 and No. 62.

Exhibit 61 constitutes pages 58 and 160 of the 1945 report of the Commissioner of Internal Revenue called "Statistics of Income."

Exhibit 62 represents pages 154 and 156 of the 1946 report of the Commissioner of Internal Revenue [219] called "Statistics of Income."

63. Tabulation, summarizing the data shown in Exhibits No. 61 and No. 62. Set out Exhibit No. 63 in full. [See page 168.]

64A to 64G. Set out in full. [See pages 169-176.]

Defendant's Exhibit A. Memorandum on incidence of income tax liability. Set out in full. [See pages 177-181.]

The undersigned, attorney for appellants, certi-

fies that in my opinion the above Statement of Evidence covers in condensed form all the evidence introduced at the trial.

Dated: August 28, 1956.

/s/ MELVIN D. WILSON

Acknowledgment of Service.

[Endorsed]: Filed Aug. 29, 1956.

PLAINTIFFS' EXHIBIT No. 1

Deed of Gift

Elgin R. Parker, of the County of Orange, State of California, in consideration of the love and affection he bears to his children, hereinafter named, does hereby give, transfer, assign, convey and deed, out of his sole and separate property, twelve and one-half per cent of all his right, title and interest in and to the following described property, to each of his children, as his or her sole and separate property, as follows:

Flo Dian Parker, born August 1, 1929,

Patricia Lee Parker, born September 19, 1932,

Rowland Tibbetts Parker, born May 1, 1937,

Arthur Elgin Parker, born September 8, 1940.

Elgin R. Parker is a partner in the partnership known as Southern Heater Company, which operates a business of manufacturing and selling heaters, said business being conducted at 133 East Palmer Street, Compton, California, and said partnership also carries on the same type of business under various other names, such as Merit Heater Com-

pany, United States Heater Company, Crown Heater Company, Southern Galvanizing Company, and Bessemer Engineering Company.

Elgin R. Parker owns a one-half interest in said partnership and a one-half interest in all the assets thereof, and by this instrument gives to each of his above named children a six and one-quarter per cent interest in the said partnership and in the assets of said partnership, as of the close of business October 31, 1943. Said assets in said partnership are more particularly described as follows:

Cash on hand and in bank, accounts receivable, merchandise inventories, inventories of materials and supplies and finished goods, buildings on the real estate hereinafter described, machinery and equipment located in the buildings on the property hereinafter described, as well as shop tools, dies, furniture and fixtures, delivery equipment, deferred accounts, accounts receivable (employees'), unexpired insurance, sundry deposits, patents and trademarks and good will, and other assets, all appertaining to the businesses of the partnerships mentioned above, carried on at 133 East Palmer Street in Compton, California, or on the property hereinafter described.

The real estate owned by said partnership and involved by this deed of gift is further described as follows:

Land on which the Plant stands:

Those portions of Wright's addition to the Town of Compton, as per map recorded in Book 7, Page 55 of Miscellaneous Records, and of Range 1 of

the Temple and Gibson Tract, as per map thereof recorded in Book 2, Pages 540 and 541 of Miscellaneous Records, in the City of Compton, County of Los Angeles, State of California, described as follows:

Beginning at the Southwest corner of Lot 2 in Block 5 of said Wright's Addition to the Town of Compton, said Southwest corner being in the Easterly line of Wilmington Street as said street is shown on the Map of Tract No. 759, as per map thereof recorded in Book 16, Page 13 of Maps; thence northerly, along the said Easterly line of Wilmington Street, 871.2 feet, to the southwest corner of Block "I," of Tract No. 8765, as per map thereof recorded in Book 41, Pages 88 and 89 of Maps; thence Easterly, along the Southerly line of said Block "I," 500 feet, to the Southeast corner of said Block "I," thence southerly parallel with the Easterly line of Wilmington Street, as hereinbefore described, 871.2 feet to the Southeast corner of Block 5 of Wright's Addition to the Town of Compton, hereinbefore described; thence Westerly, along the Southerly line of said Block 5, a distance of 500 feet, to the point of beginning.

Otherwise known as 133 East Palmer, Compton, California.

it being understood that the donor is giving a six and one-quarter per cent interest in and to said assets and real estate to each of his said children named above.

The gifts, assignments and conveyances of the six and one-quarter per cent interest in and to the

partnership and in and to the assets of the said partnership are subject to the liabilities of the partnership, as shown in Schedule "A," attached hereto, and to such further liabilities for renegotiations, Federal Income Taxes on Elgin R. Parker and Flo Parker, for the years 1941, 1942 and 1943, as may finally be determined to be due, and for such other liabilities as may arise and be determined to be a liability of the business as of October 31, 1943, including liabilities to Elgin R. Parker and Flo Parker, as shown in Exhibit "A."

To Have and to Hold to the several grantees as their respective sole and separate property.

Witness my hand this thirty-first day of October, 1943.

/s/ ELGIN R. PARKER

State of California

County of Los Angeles—ss.

On this thirty-first day of October, 1943, before me, a Notary Public in and for said County, personally appeared Elgin R. Parker, known to me to be the person whose name is subscribed to the foregoing instrument, and acknowledged that he executed the same.

Witness my hand and official seal.

[Seal] /s/ CAPITOLA FIERKE

Notary Public in and for said County and State.
My Commission expires Sept. 28, 1946.

The above gifts are from the separate property

of my husband, Elgin R. Parker, and while I have no interest in said property, I approve of such gifts.

/s/ FLO PARKER

[Note: Exhibit A is the same as Exhibit No. 58 set out at pages 163-164 of this printed record.]

PLAINTIFFS' EXHIBIT No. 3

Articles of Copartnership

These Articles of Copartnership, made and entered into as of the first day of November, 1943, by and between Elgin R. Parker, Flo Parker, and Elgin R. Parker, as guardian of the properties of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker, and Arthur Elgin Parker, minors, Witnesseth:

1. The parties hereto have agreed, and do hereby agree, to become partners together, under the fictitious firm name and style of Southern Heater Company. The said partnership will also use the firm names of Merit Heater Company, United States Heater Company, Crown Heater Company, Southern Galvanizing Company, and Bessemer Engineering Company.

2. Said partnerships shall carry on and conduct a business of manufacturing and selling water heaters; and shall carry on any other business in connection with the foregoing or in furtherance of the partnership purposes, and shall engage in any business or transaction whatsoever, which the partners may from time to time agree upon, to the same extent as natural persons might or could do.

3. The place of business of said partnership is 133 East Palmer Street, Compton, California, which place may be changed from time to time by agreement of the partners.

4. Said partnership shall continue for the common and mutual benefit and advantage of the parties hereto, subject to the terms and conditions of this agreement, until such time as the same shall be dissolved by any of the partners or by operation of law.

5. (a) The partners have contributed, and do hereby contribute, and by these presents do assign, transfer and set over and deliver unto the partnership, for partnership purposes, all of the assets of that certain manufacturing water heater business heretofore operated by Elgin R. Parker and Flo Parker, as copartners under the fictitious firm names of Southern Heater Company, Merit Heater Company, United States Heater Company, Crown Heater Company, Southern Galvanizing Company, and Bessemer Engineering Company. Said assets, contributed to the partnership, as aforesaid, are now owned by the parties hereto in the following proportions: Elgin R. Parker 25 per cent, Flo Parker, 25 per cent, Flo Dian Parker $12\frac{1}{2}$ per cent, Patricia Lee Parker $12\frac{1}{2}$ per cent, Rowland Tibbetts Parker $12\frac{1}{2}$ per cent, and Arthur Elgin Parker $12\frac{1}{2}$ per cent; the last four named partners operating through their guardian, Elgin R. Parker. It is hereby declared that henceforth all of said assets shall belong to the partnership hereby created, but the respective interests of the parties

hereto in the partnership and the capital, income, profits and proceeds thereof and therefrom, shall be the sole and separate property of each of said parties free from any community or other interest on the part of the other parties.

(b) The transfer of said assets to the partnership, as aforesaid, is subject to liabilities, which liabilities the partnership does hereby assume. An itemized list of said assets and of the known liabilities, is contained in the balance sheet as of October 31, 1943, hereinafter annexed and made a part hereof. It is understood that the assets are subject to liabilities not shown in the attached balance sheet: for renegotiation, such Federal and State income taxes on Flo Parker and Elgin R. Parker for the years 1941, 1942 and 1943, as may finally be determined to be due, and for such other liabilities as may arise and be determined to be a liability of the predecessor business, or of Elgin R. Parker or of Flo Parker, as of October 31, 1943.

6. The capital of the partnership shall consist of:

(a) The assets listed on said balance sheet at October 31, 1943, hereunto annexed;

(b) Any and all other or further contributions which the partners, or any of them, may hereafter make; and

(c) All machinery, equipment, contracts, goodwill, property and assets of every kind, which the partnership may hereafter in any manner acquire.

7. (a) The partners shall have interests in and to the capital of the partnership in the following

proportions: Elgin R. Parker 25 per cent, Flo Parker 25 per cent, Flo Dian Parker $12\frac{1}{2}$ per cent, Patricia Lee Parker $12\frac{1}{2}$ per cent, Rowland Tibbetts Parker $12\frac{1}{2}$ per cent, and Arthur Elgin Parker $12\frac{1}{2}$ per cent, in and to the partnership capital.

(b) Inasmuch as Elgin R. Parker proposes to devote a greater amount of his time to the partnership affairs than do the other partners, and will, therefore, render a greater amount of service thereto, it is agreed that all net income or net profits derived from the partnership shall belong to the parties hereto in the following proportions: After deducting the salary provided for in paragraph 10 hereof, 25 per cent to Elgin R. Parker, 25 per cent to Flo Parker, $12\frac{1}{2}$ per cent to Flo Dian Parker, $12\frac{1}{2}$ per cent to Patricia Lee Parker, $12\frac{1}{2}$ per cent to Rowland Tibbetts Parker, and $12\frac{1}{2}$ per cent to Arthur Elgin Parker.

8. The net income and net profits of the partnership shall be paid and distributed to the parties hereto in the proportions above set forth from time to time as the partners may determine, and any and all losses or expenses incurred in connection with the partnership business and affairs shall be borne and paid by the partners in the same proportions at the net income and net profits are divided, that is to say, 25 per cent to Elgin R. Parker, 25 per cent to Flo Parker, $12\frac{1}{2}$ per cent to Flo Dian Parker, $12\frac{1}{2}$ per cent to Patricia Lee Parker, $12\frac{1}{2}$ per cent to Rowland Tibbetts Parker, and $12\frac{1}{2}$ per cent to Arthur Elgin Parker.

9. The net income and net profits of the partner-

ship shall be determined and computed in accordance with the standard and prevailing accounting practices, with the usual deductions for operating expenses, depreciation, taxes and other items, as approved by a certified public accountant or accountants selected by the partners.

10. It is understood and agreed that the partners may from time to time authorize the payment to any of the partners, in addition to their share of the net profits, of salaries, bonuses, or other compensation for services rendered to the partnership, in which event such salaries, bonuses or other compensation shall be charged to the operating expenses of the partnership. Until further agreement, Elgin R. Parker shall receive a salary of Twelve Thousand Dollars (\$12,000) per year.

11. At all times during the continuance of said partnership, each of the parties hereto shall give a sufficient amount of his or her time, attention and attendance to the conduct of the business of the partnership as shall be necessary and proper for the efficient operation of said business and the carrying out of the purposes of the partnership; and each of the partners will at all times, to the utmost of his skill and power, exert his best efforts for the joint interest, benefit and advantage of the partners and the business of the partnership. All partners shall be kept fully advised with respect to the partnership business and affairs.

12. There shall at all times be kept during the continuance of said partnership just and true books of account, wherein shall be entered a record of all

moneys received and disbursed and all other transactions in connection with the partnership business; and said books shall be used in common by the partners, and any of them shall have access thereto at any time without interruption or hindrance from the others. The books of the partnership shall be balanced from time to time as the partners may agree, in such manner as to exhibit the true state and condition of the affairs of the partnership. None of the partners shall receive or pay out any money or engage in any transaction on behalf of the partnership unless the same shall be immediately entered in the books and accounts of the partnership.

13. None of the partners shall have the right to sell, transfer, assign or convey his or her interest in the partnership or its business, property or assets, or any part thereof, without giving the other partners the prior right and option to purchase such interest, at the same price and upon the same terms and conditions, for a period of ninety (90) days after notice in writing to the other partners of his or her intention to make such sale or transfer. Such notice shall be given in writing by the partner desiring to sell, and shall specify the price the selling partner is to receive for his or her interest, and the terms of payment thereof. The remaining partners shall thereupon have the right and option for a period of ninety (90) days from the giving of said notice, to purchase the interest of the partners desiring to sell at the same price and upon the same terms, which option shall be exercised by notice in writing to the partner desiring to sell. The

remaining partners may participate in this right to purchase in their respective proportions. Should one or more partners not desire to participate in the purchase of additional partnership interest, then the other remaining partners shall have the right to participate in the purchase, in their respective proportions.

14. Any notice given hereunder may be given by personal delivery to parties to whom the same is directed, or same may be forwarded to such parties by registered mail at his or her last known address. In case of service by registered mail, such notice shall be deposited in the United States mail in the County of Los Angeles, State of California, and notice shall be deemed to have been given on the date of mailing.

15. Upon any dissolution of said partnership, a full and final accounting of the assets and property of the partnership shall be taken, and the same shall, as soon as practicable, be liquidated, and the debts due the partnership collected and the proceeds applied first to the discharge of the liabilities of the partnership and the expenses of liquidation, and the surplus, if any, shall be divided between the partners, their heirs, executors or administrators in proportion to their respective interests in the capital of the partnership.

16. This agreement shall bind and inure to the benefit of the respective heirs, executors and administrators of the parties hereto. The masculine gender, when used herein shall be deemed to include the feminine, and the singular shall include the plural and the plural the singular.

Executed as of the day and year first above written.

/s/ ELGIN R. PARKER.

/s/ FLO PARKER.

FLO DIAN PARKER,

By /s/ ELGIN R. PARKER,

Guardian.

PATRICIA LEE PARKER,

By /s/ ELGIN R. PARKER,

Guardian.

ROWLAND TIBBETTS

PARKER,

By /s/ ELGIN R. PARKER,

Guardian.

. ARTHUR ELGIN PARKER,

By /s/ ELGIN R. PARKER,

Guardian.

State of California,
County of Los Angeles—ss.

On this 25th day of February, 1944, before me, a Notary Public in and for said County and State, personally appeared Elgin R. Parker, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] /s/ CAPITOLA FIERKE,

Notary Public in and for the County of Los Angeles, State of California. My Commission Expires Sept. 28, 1946.

State of California,
County of Los Angeles—ss.

On this 25th day of February, 1944, before me, a Notary Public in and for said County and State, personally appeared Flo Parker, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that she executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] /s/ CAPITOLA FIERKE,
Notary Public in and for the County of Los Angeles, State of California. My Commission Expires Sept. 28, 1946.

State of California,
County of Los Angeles—ss.

On this 25th day of February, 1944, before me, a Notary Public in and for said County and State, personally appeared Elgin R. Parker, as guardian of the estates of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker, and Arthur Elgin Parker, known to me to be the person whose name is subscribed to the within instrument, and acknowledged to me that he executed the same.

In Witness Whereof, I have hereunto set my hand and affixed my official seal the day and year in this certificate first above written.

[Seal] /s/ CAPITOLA FIERKE,
Notary Public in and for the County of Los Angeles, State of California. My Commission Expires Sept. 28, 1946.

PLAINTIFFS' EXHIBIT No. 10

Agreement for Dissolution of Partnership

This Agreement made this 30th day of November, 1948, entered into between Elgin R. Parker, Flo Parker, and Elgin R. Parker, as guardian of the properties of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker and Arthur Elgin Parker,

Witnesseth:

Whereas, as of the 1st day of November, 1943, the parties entered into Articles of Co-partnership to operate a business known as Southern Heater Company and also known as Merit Heater Company, United States Heater Company, Crown Heater Company, Southern Galvanizing Company, Bessemer Engineering Company and American Control Company; and

Whereas, it is deemed to the best interests of the parties hereto that said partnership be dissolved inasmuch as the active operating business has been transferred to various corporations and the partnership now merely holds stock in said corporations and notes of the partners.

Now, Therefore, be it understood and agreed as follows:

1. That the partnership known by the above names shall be dissolved as of November 1, 1948.

2. That the assets and liabilities of the partnership as of October 31, 1948, are as shown on Exhibit A attached hereto.

3. That the interests of the partners in the partnership as of November 1, 1948, were as follows:

Elgin R. Parker.....	25%
Flo Parker	25%
Flo Dian Parker.....	12½%
Patricia Lee Parker.....	12½%
Rowland Tibbetts Parker.....	12½%
Arthur Elgin Parker.....	12½%

It is understood that the stock of Southern Heater Corporation, American Control Corporation, Parker Realty Company and Radiantair Control Corporation will be divided among the partners in relation to their interests in the partnership.

4. It is further agreed that the notes receivable from partners, owned by the partnership, will be distributed to the partners as follows:

(a) To Elgin R. Parker:

Note signed by E. R. Parker for \$26,217.92;
Note signed by Flo Parker for \$27,464.71;

(b) To Flo Parker:

Note signed by E. R. Parker for \$26,217.92;
Note signed by Flo Parker for \$27,464.71;

(c) To Flo Dian Parker:

Note signed by E. R. Parker for \$13,108.95;
Note signed by Flo Parker for \$13,732.35;

(d) To Patricia Lee Parker:

Note signed by E. R. Parker for \$13,108.95;
Note signed by Flo Parker for \$13,732.35;

(e) To Rowland Tibbetts Parker:

Note signed by E. R. Parker for \$13,108.96;
Note signed by Flo Parker for \$13,732.35;

(f) To Arthur Elgin Parker:

 Note signed by E. R. Parker for \$13,108.96;

 Note signed by Flo Parker for \$13,732.35.

5. It is understood that the remaining assets in the partnership will be divided among the partners in proportion to their interests in the firm and that each will assume and be subject to a pro rata share of the liabilities of the partnership as shown by Exhibit A.

6. It is agreed that Elgin R. Parker, as one of the partners, shall assign, on behalf of the partnership, the notes, stocks and other assets to the respective partners and that this partnership will cease to exist as of November 1, 1948.

7. It is agreed that notice of the dissolution of the partnership will be published in the Los Angeles Daily Journal and that a notice of the dissolution will be filed with the County Clerk of Los Angeles County, California.

Witness our hands and seals this 30th day of November, 1948.

 /s/ ELGIN R. PARKER,

 /s/ FLO PARKER,

 /s/ ELGIN R. PARKER,

As Guardian of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker and Arthur Elgin Parker.

Exhibit "A"

Southern Heater Company
Statement of Assets and Liabilities
As at October 31, 1948

Assets

Cash in Bank	1,328.88
Notes Receivable from Mr. and Mrs. Parker	214,730.48
Accounts Receivable—Sundry	258.21
Investments in Stocks (At Cost):	
Southern Heater Corporation	340,222.76
Parker Realty Corporation	58,000.00
American Control Corporation	52,000.00
Radiantair Control Corporation	15,000.00
	<hr/>
Total Assets	681,540.33

Liabilities

Accounts Payable—Sundry	4,820.96
	<hr/>
Partnership Capital	676,719.37
	<hr/>
Detail of Partners' Accounts:	
E. R. Parker	169,179.83
Flo Parker	169,179.84
Arthur Parker	84,589.92
Patricia Lee Parker	84,589.92
Flo Dian Parker	84,589.93
Rowland T. Parker	84,589.93
	<hr/>
	676,719.37
	<hr/>

PLAINTIFFS' EXHIBIT No. 13

In the Superior Court of the State of California
in and for the County of Orange
No. A-11392

In the Matter of the Guardianship of FLO DIAN
PARKER, PATRICIA LEE PARKER,
ROWLAND TIBBETTS PARKER, and
ARTHUR ELGIN PARKER, Minors.

APPLICATION FOR INSTRUCTION ON
INVESTMENT OF FUNDS OF WARDS

To the Superior Court of the State of California
in and for the County of Orange:

Petitioner, Elgin R. Parker, represents as follows:

That he filed a petition for appointment of guardian of his minor children, Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker, and Arthur Elgin Parker, in the above entitled Court, and that on the thirty-first day of December, 1943, the Honorable Court made an order appointing him guardian upon his giving a bond to said minors, and each of them, if given by a surety company authorized to furnish such bond, in the sum of Twenty-three Thousand Dollars (\$23,000), and taking the oath required by law;

That your petitioner has taken up with several surety companies the matter of procuring said bonds.

The only condition upon which any surety company will write these bonds is that the Court make an order under Section 1557 of the Probate Code, instructing the guardian to enter into the partnership agreement with other owners of interests in the business known as Southern Heater Company, and instructing the guardian to keep the property of the wards invested in the partnership interests of said Southern Heater Company, with authority in the guardian, as partner, to retain in the partnership some of the profits of the business.

As a matter of background, it may be explained that your petitioner, Elgin R. Parker, and his wife, Flo Parker, were, prior to October 31, 1943, equal copartners and owners of the business of manufacturing heaters, with a business address at 133 East Palmer Street, Compton, California.

On October 31, 1943, affiant gave to each of his four children a $6\frac{1}{4}$ per cent interest in and to the assets of said partnership and in said partnership interest, and Flo Parker, the mother of said children, gave to each of said four children a $6\frac{1}{4}$ per cent interest in and to the assets of said partnership, and interest in said partnership, with the result that your petitioner owns a 25 per cent interest in said business, his wife, Flo Parker, owns a 25 per cent interest in said business, and each of the four children own a $12\frac{1}{2}$ per cent interest in said business.

It is now necessary for a new partnership agreement to be entered into by and between the petitioner, his wife, and the guardian for the four guardianship estates.

Petitioner has built up said business to the point where it earns a substantial profit, and earned a substantial profit before the war. A copy of the balance sheet was attached to the original petition for appointment of the guardian. It shows that the business is in good financial condition.

It is to the best interests of the said guardianship estates, from the standpoint of participating in the earnings of a going business, and from the standpoint of income and estate taxes, that the guardian

enter into a partnership agreement and continue to own an interest in the said partnership of Southern Heater Company. It is expected that the business will continue to prosper, and that the guardianship estates will enjoy their share of the profits and that substantial estates will be built up for the said wards. It will be prudent for the partnership to retain some of the profits, in good years, to enable the firm to tide over lean years.

On the other hand, should your petitioner fail to secure the instruction he needs, so that he will be unable to qualify as guardian, the interest in the business which the wards now own would probably have to be sold or liquidated. Your petitioner and his wife are probably the only persons who would want to buy an interest in this closely held business, and your petitioner is not in a financial position to do so. The result would be that the business would probably have to be liquidated and the properties of the wards invested in low interest-bearing securities, and your petitioner would have his business terminated. Under said circumstances the income from the wards' estates, and perhaps the capital of the wards' estates, might have to be used for their support, with the end that the guardianship estates would surely be reduced and perhaps entirely used up.

Consequently, your petitioner can confidently say that it is to the best interests of the guardianship estates that the original plans be carried forward, and that the Court order and instruct your petitioner to retain the interest in the partnership and

enter into a new partnership agreement, in a form to be approved by the Court, which agreement will authorize the partnership to retain some of the profits.

Wherefore, petitioner prays for a hearing on the petition and that the Court make an order authorizing and instructing your petitioner to enter into a partnership agreement with your petitioner, Flo Parker, and the guardian for the four guardianship estates; the business to be known as the Southern Heater Company; which said business also uses various other names, such as Merit Heater Company, United States Heater Company, Crown Heater Company, Southern Galvanizing Company, and Bessemer Engineering Company, said partnership agreement to authorize the partnership to retain profits in the business, at the discretion of the partners, and instructing your petitioner to continue to hold the interests in said partnership business and assets; and for further orders as may be proper in the premises.

In view of the fact that your petitioner is the guardian, it is requested that the Court order that notice be dispensed with.

Dated February 3, 1944.

ELGIN R. PARKER,

Petitioner

MELVIN D. WILSON,

Attorney for Petitioner

Duly Verified.

[Endorsed]: Filed Feb. 7, 1944.

PLAINTIFFS' EXHIBIT No. 26

[Title of Superior Court and Cause.]

APPLICATION FOR AUTHORITY
TO COMPROMISE CLAIMS

To the Superior Court of the State of California
in and for the County of Orange:

Petitioner, Elgin R. Parker, represents as follows:

That he is the duly appointed and acting guardian of the estates of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker and Arthur Elgin Parker, minors, having been appointed on the 31st day of December, 1943, and having posted the proper surety bond required by the order of the Court.

Each guardianship estate consists of a 12½% interest in and to the business and assets of a partnership known as Southern Heater Company and Series "E" United States Government Bonds in the face value of \$3,750.00. As of October 31, 1945, the interest of each guardianship estate in the capital of the partnership amounted to \$54,417.94 book value. The partnership assets consist of all of the stock of Southern Heater Corporation, a California corporation, and all of the stock of American Control Corporation, a California corporation, real estate, bank accounts and minor miscellaneous assets.

As of October 31, 1943, your petitioner and his wife, Flo Parker, were equal partners owning the

business known as Southern Heater Company. On that date each of them gave to each of their four children named herein a $6\frac{1}{4}\%$ interest in and to the assets and business of said Southern Heater Company, a co-partnership. After the gift, with the approval of this Court, the guardian entered into a partnership agreement wherein the four children and their parents became partners under the firm name of Southern Heater Company. At the time of the gift and of the creation of the partnership it was expected and anticipated that each of the partners, including the four minors, would be taxable upon their shares of the partnership income. Each of the six persons filed Federal and State income tax returns and paid the tax shown on their income from the partnership.

The Commissioner of Internal Revenue through the Internal Revenue Agent in Charge at Los Angeles, California, has made an examination of the income tax returns of the partnership and of the six partners for the period ending October 31, 1944, and has rendered a report under date of July 15, 1946.

The Commissioner of Internal Revenue has taken the position that the children's interest in the partnership will not be recognized for income tax purposes and that all the income of the partnership will be taxed to their parents. The Commissioner has proposed additional Federal income taxes for the year ended October 31, 1944, as follows:

Elgin R. Parker.....\$55,589.70

Flo Parker 55,562.19

The Commissioner has offered to refund to each guardianship estate the taxes paid by it for the year 1944 in the amount of \$13,986.09 each.

It will be seen that the inclusion in the parents' return of the children's share of the partnership income results in a greater additional tax than the refunds offered to the children. This is due to the fact that the income tax rates increase as the amount of income increases.

The Commissioner bases his contention upon decisions of the Supreme Court of the United States in *A. L. Lusthaus vs. Commissioner*, 66 Sup. Ct. 539, and *Frances E. Tower vs. Commissioner*, 66 Sup. Ct. 532, both decided February 25, 1946, wherein the income of so-called family partnerships was taxed to the husbands who had built up the business. Since the decisions of the Supreme Court, the Tax Court of the United States and other Federal Courts have followed the Supreme Court cases in facts more nearly paralleling those in the cases involved in the instant case.

It will be seen with respect to the partners of Southern Heater Company that if the adult partners are required to pay the tax on all of the income of the partnership they will have to draw their portions of the income and capital out of the business with the result that in the long run the children will own the business and the parents will have nothing. If this was carried to its logical conclusion the parents would, of course, be completely without assets with which to pay the income tax and the children would own the entire business.

This was not the intention of the parents in making gifts to the children. It was intended that each would pay the tax on his or her share of the income.

It seems entirely probable that the claims of the Commissioner of Internal Revenue in this case will be sustained by the Tax Court and the other Courts of the United States and by the State tax authorities. Your petitioner and his wife will probably file protests and endeavor to effect some settlement and saving of tax but it appears that this is an undertaking with very little prospect of success.

Your petitioner, as an individual, and his wife, Flo Parker, as the donors of interest to the children, believe and claim that if they are required to pay income tax on the whole of the income of the partnership of Southern Heater Company that the guardianship estates herein involved should transfer to your petitioner and his wife sufficient amounts of money, properties or credits to enable the petitioner and his wife to pay the additional taxes involved. In other words, the guardianship estates should turn over to the petitioner and his wife for the year 1944 an amount equal to the net additional tax demanded by the Commissioner of \$111,151.89. The guardianship estates should turn over to the parents, the claimants herein, amounts equal to the refunds which the guardianship estates may receive from the Collector of Internal Revenue aggregating \$55,944.36 and additional money, properties or credits in an amount of \$55,207.53. This could be done by transferring a credit of \$111,151.89 from the capital accounts of the guardian-

ship estates on the partnership books of Southern Heater Company to your petitioner and Flo Parker in the amounts of \$55,075.94 each, for a total of \$111,151.89.

The petitioner and his wife, Flo Parker, believe that such an adjustment is required by the circumstances of the case, by their intention in making the original gifts, by the impossibility of going on with the situation if such adjustment is not made, and by the equities of the case.

If approval of the compromise herein requested is not granted it is obvious that it will not be long before the Commissioner of Internal Revenue will be filing claims against the guardianship estates for the income taxes due from the parents on the total income of the partnership. In such case the Commissioner would probably distrain upon the partnership assets and disrupt, if not ruin, the business.

It is believed, therefore, that it is for the best interests of the guardianship estates and for the advantage of the wards that this adjustment be made and that this compromise be approved.

Wherefore, your petitioner prays that the Court hear this matter and authorize the guardian on behalf of the guardianship estates to turn over to Elgin R. Parker and Flo Parker out of the guardianship estates interests in the capital of Southern Heater Company in the amount of \$55,075.94 for the benefit of Elgin R. Parker and the amount of \$55,075.94 for the benefit of Flo Parker on account of 1944 Federal income taxes.

It is further prayed that the Court hear this mat-

ter and authorize the guardian on behalf of the guardianship estates to turn over to Elgin R. Parker and Flo Parker out of the guardianship estates interests in the capital of Southern Heater Company for the benefit of Elgin R. Parker and for the benefit of Flo Parker on account of 1944 State income taxes, when the State returns have been audited and the additional State income taxes due from petitioner and his wife, Flo Parker, have been determined, and for further orders as may be proper in the premises.

In view of the fact that your petitioner is the guardian of the respective guardianship estates, it is requested that the Court order that notice be dispensed with.

Dated August 17, 1946.

/s/ ELGIN R. PARKER

Petitioner.

/s/ MELVIN D. WILSON,

Attorney for Petitioner.

Duly Verified.

[Endorsed]: Filed Aug. 27, 1946.

PLAINTIFFS' EXHIBIT No. 28

[Title of Superior Court and Cause.]

APPLICATION FOR AUTHORITY
TO COMPROMISE CLAIMS

To the Superior Court of the State of California
in and for the County of Orange:

Petitioner, Elgin R. Parker, represents as follows:

With respect to the application for authority to compromise claims for the year ended October 31, 1944, heretofore filed by your petitioner in August of 1946, the Court is advised that Elgin R. Parker and Flo Parker have decided to pay the additional income taxes proposed by the Commissioner of Internal Revenue for the year 1944, to file claims for refund and to prosecute the same in the Federal District Court in Los Angeles.

The Commissioner of Internal Revenue has proposed additional Federal income taxes for the year ended October 31, 1944, against the parties as follows:

Elgin R. Parker.....	\$55,589.70
Flo Parker	55,562.19

The Commissioner has offered to refund to each guardianship estate the taxes paid by it for the year 1944 in the amount of \$13,986.09 each.

Elgin R. Parker and Flo Parker would like to pay said additional taxes in part by cash and in part by offsetting the refunds due to the guardianship estates against the additional taxes due from the parents. This procedure is satisfactory with the Commissioner of Internal Revenue but your petitioner would like approval of the Court therefor.

Your petitioner prays approval of the following steps and procedures:

1. That he as guardian be authorized by this Court to sign an offset statement with Elgin R. Parker and Flo Parker and the Commissioner of

Internal Revenue whereby the refunds due to the guardianship estates for the year 1944 may be credited against the additional taxes claimed by the Commissioner of Internal Revenue to be due from Elgin R. Parker and Flo Parker for the year 1944.

2. That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue with respect to the incidence of the tax on the income of this partnership that Elgin R. Parker and Flo Parker be permitted to keep and retain said refunds in at least part settlement of their claims against the guardianship estate on account of income taxes.

3. In the event that Elgin R. Parker and Flo Parker eventually win their litigation with the Commissioner of Internal Revenue with respect to the incidence of tax on the income of this partnership for the year 1944 that Elgin R. Parker and Flo Parker pay to these guardianship estates the said refunds of \$13,986.09 each, plus any interest benefits that have been obtained by said Elgin R. Parker and Flo Parker and that this procedure be in complete settlement of said claims by said Elgin R. Parker and Flo Parker against said guardianship.

4. That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue respecting income tax on the income of this partnership for the year 1944 that the matter of the claims by Elgin R. Parker and Flo Parker against these guardianship estates on account of income taxes for that year be

further considered and, if necessary, adjudicated.

5. That arrangements similar to the above be made with respect to California income taxes in the event that the Franchise Tax Commissioner of the State of California makes determinations similar to those made by the Commissioner of Internal Revenue for the year 1944.

Dated April 7, 1947.

/s/ ELGIN R. PARKER,

Petitioner.

/s/ MELVIN D. WILSON,

Attorney for Petitioner.

Duly Verified.

[Endorsed]: Filed April 11, 1947.

PLAINTIFFS' EXHIBIT No. 31

[Title of Superior Court and Cause.]

ORDER FOR AUTHORITY TO COMPROMISE
CLAIMS

The petition of Elgin R. Parker, as guardian of the estates of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker and Arthur Elgin Parker, minors, for authority to compromise claims against the guardian coming on regularly to be heard this 25th day of April, 1947, and the Court, after examining the petition and hearing the evidence, finds that notice of the time and place of said hearing has been duly given as required by law and that no persons appearing to except to or

contest said petition, and finds that all the allegations of said petition are true and that the conditional or tentative compromise of claims prayed for in said petition is equitable and proper and correct,

It is, therefore, ordered by the Court that the guardian of each of said guardianship estates is hereby authorized as follows:

1. That he as guardian is hereby authorized by this Court to sign an offset statement with Elgin R. Parker and Flo Parker and the Commissioner of Internal Revenue whereby the refunds due to the guardianship estates for the year 1944 may be credited against the additional taxes claimed by the Commissioner of Internal Revenue to be due from Elgin R. Parker and Flo Parker for the year 1944.

2. That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue with respect to the incidence of the tax on the income of this partnership that Elgin R. Parker and Flo Parker be permitted to keep and retain said refunds in at least part settlement of their claims against the guardianship estate on account of income taxes, and that the claims of Elgin R. Parker and Flo Parker be further considered, and if necessary, adjudicated.

3. In the event that Elgin R. Parker and Flo Parker eventually win their litigation with the Commissioner of Internal Revenue with respect to the incidence of tax on the income of this partnership for the year 1944 that Elgin R. Parker and Flo Parker pay to these guardianship estates the

said refunds of \$13,986.09 each, plus any interest benefits that have been obtained by said Elgin R. Parker and Flo Parker and that this procedure be in complete settlement of said claims by said Elgin R. Parker and Flo Parker against said guardianship.

4. That arrangements similar to the above be made with respect to California income taxes in the event that the Franchise Tax Commissioner of the State of California makes determinations similar to those made by the Commissioner of Internal Revenue for the year 1944.

Dated: 4/25/47.

/s/ R. THOMPSON

Judge of the Superior Court

[Endorsed]: Filed April 25, 1947.

PLAINTIFFS' EXHIBIT No. 34

[Title of Superior Court and Cause.]

ORDER SETTLING FOURTH ANNUAL ACCOUNT OF GUARDIAN AND ORDER FOR PAYMENT OF ATTORNEYS' FEES AND ORDER FOR AUTHORITY TO COMPROMISE CLAIMS AND ORDER INSTRUCTING GUARDIAN ON INVESTMENT OF FUNDS OF WARDS

Comes now Elgin R. Parker, guardian of the guardianship estates of Flo Dian Parker, Patricia Lee Parker, Rowland Tibbetts Parker and Arthur

Elgin Parker, minors, by Melvin D. Wilson, Attorney, and presents to the Court for settlement his Fourth Annual Account showing charges in favor of each of said guardianship estates amounting to \$89,078.02 and claiming credits amounting to \$1,084.50, leaving a balance of \$87,993.52 in his hands belonging to each of said guardianship estates, subject to unsettled claims of Elgin R. Parker and Flo Parker for adjustment on account of federal and state income taxes for the years 1944, 1945 and 1946; that he now proves to the satisfaction of the Court that said account was filed on or about the day of July, 1948; that the Clerk thereupon appointed the 30th day of July, 1948, as the time for the settlement thereof; that notice of the time and place of said settlement has been duly given as required by law and that no person appearing to except to or contest said account, the Court, after hearing evidence, finds said account correct and that the attorney's fees set forth in the accompanying report are justly due and payable out of said estate.

It Is Therefore Ordered, Adjudged and Decreed by the Court that said account be in all respects approved, allowed and settled and that Elgin R. Parker forthwith, out of the moneys in his hands belonging to said estates, pay to Melvin D. Wilson, Esq., the amount of \$400.00.

It Is Also Ordered, Adjudged and Decreed by the Court that the action of the guardian of each of said guardianship estates in retaining in the partnership of Southern Heater Company the earn-

ings thereof for the seventeen months period ended March 31, 1948, excepting the withdrawals for personal use and current federal and state income taxes in the amount of \$1,084.50 for each estate, be hereby approved, allowed and settled.

The petition of Elgin R. Parker, as guardian of the above named estates, for authority to compromise claims against the guardian and the application for instruction on investment of funds of wards, coming on regularly to be heard this 30th day of July, 1948, and the Court, after examining the petition and hearing the evidence, finds that notice of the time and place of such hearing has been duly given as required by law and that no person appearing to except to or contest said petition, finds that all of the allegations of said petition are true and that the conditional or tentative compromise of claims prayed for in said petition is equitable and proper and correct.

It Is Therefore Ordered by the Court that the guardian of each of said guardianship estates is hereby authorized as follows:

1. That he as guardian is authorized by this Court to sign an offset statement with Elgin R. Parker and Flo Parker and the Commissioner of Internal Revenue where the refunds due to the guardianship estates for the years 1945 and 1946 may be credited against the additional taxes claimed by the Commissioner of Internal Revenue to be due from Elgin R. Parker and Flo Parker for the years 1945 and 1946.

2. That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue with respect to the incidence of the tax on the income of this partnership that Elgin R. Parker and Flo Parker are permitted to keep and retain said refunds in at least part settlement of their claims against the guardianship estates on account of income taxes.

3. In the event that Elgin R. Parker and Flo Parker eventually win their litigation with the Commissioner of Internal Revenue with respect to the incidence of tax on the income of this partnership for the years 1945 and 1946 that Elgin R. Parker and Flo Parker pay to these guardianship estates the said refunds, plus any interest benefits that have been obtained by said Elgin R. Parker and Flo Parker thereon and that this procedure is in complete settlement of said claims by said Elgin R. Parker and Flo Parker against said guardianships.

4. That in the event Elgin R. Parker and Flo Parker eventually lose their litigation with the Commissioner of Internal Revenue respecting income tax on the income of this partnership for the years 1945 and 1946 that the matter of the claims by Elgin R. Parker and Flo Parker against these guardianship estates on account of income taxes for those years be further considered and, if necessary, adjudicated.

5. That arrangements similar to the above be made with respect to California income taxes in the

event that the Franchise Tax Commissioner of the State of California makes determinations similar to those made by the Commissioner of Internal Revenue for the years 1945 and 1946.

The Court Further Orders that Elgin R. Parker, as guardian of the above entitled guardianship estates, be hereby authorized and instructed to participate in taking the following steps:

1. To cause the formation of a corporation to be known as The Parker Corporation, or a similar name, with an authorized capital of \$100,000.00 consisting of 1,000 shares of capital stock, each of a par value of \$100.00; to transfer to said corporation from the assets of Southern Heater Company (a partnership) real property of a book value of approximately \$57,479.04 and cash in the amount of \$886.36, consideration for the issuance by said corporation to the partnership of stock of the par value of \$58,000.00, to be the then only outstanding stock of said corporation.

2. The partnership known as Southern Heater Company may continue in operation owning cash, stocks and other assets.

3. The above transfer to be made conditional upon obtaining approval of the surety and the pertinent state and federal authorities.

Dated: This 30th day of July, 1948.

/s/ ROBERT GARDNER,

Judge of the Superior Court.

[Endorsed]: Filed July 30, 1948.

PLAINTIFFS' EXHIBIT No. 39

[Title of Superior Court and Cause.]

SIXTH ANNUAL ACCOUNT OF GUARDIAN,
FINAL ACCOUNT, REPORT AND PETI-
TION FOR DISTRIBUTION OF THE
GUARDIANSHIP OF FLO DIAN PARKER,
APPLICATION FOR AUTHORITY TO
COMPROMISE CLAIMS, AND PETITION
FOR ALLOWANCE OF ATTORNEY'S
FEES

To the Superior Court of the State of California,
in and for the County of Orange:

Elgin R. Parker, as guardian of the estates of
Flo Dian Parker, Patricia Lee Parker, Rowland
Tibbetts Parker and Arthur Elgin Parker, minors,
renders to the Court his Sixth Account Current and
report of his administration of said guardianship
estates up to and including the 31st day of July,
1950, as follows:

Letters of Guardianship were duly issued to him
on the 14th day of February, 1944.

An inventory and appraisement of said guardian-
ship estates was returned and filed on or about the
26th day of April, 1945, showing the value of said
estates to be \$24,745.98 each.

On the 1st day of March, 1944, an Order for
Instruction to sign a partnership agreement was
entered and immediately thereafter the articles of
co-partnership were signed as of November 1, 1943.

A form of articles of co-partnership was presented to and approved by the Court.

Four claims have been presented against the guardianship estates and have not been settled, except on a tentative basis.

Sixth Annual Account

Said guardian is chargeable for each guardian estate as follows:

Balance chargeable from Fifth Account	\$88,339.92
Income for the period November 1, 1948,	
to July 31, 1950, as per Exhibit A	6,061.62
Total Charges	<u>\$94,401.54</u>

Said guardian is entitled to credits as follows:

Disbursements as per Exhibit A	\$ 4,344.76
Balance chargeable to next account	90,056.78

The balance consists of the items shown on Exhibit B which total \$90,056.78.

Your petitioner has been required to employ Melvin D. Wilson, Esquire, to prepare the Sixth Account and the Final Account, Report and Petition for Distribution for Flo Dian Parker and the Petition for Authority to Compromise Claims and your petitioner also employed the said Melvin D. Wilson to prepare the Application for Instruction on Investment of Funds of Flo Dian Parker, ward, and said attorney attended Court at Santa Ana, California, on two occasions in connection with the above matter. Your guardian has agreed, subject

to the approval of the Court, to pay said attorney, the sum of One Hundred Dollars (\$100.00) for each of the guardianship accounts other than for Flo Dian Parker and to pay said attorney the sum of Three Hundred Dollars (\$300.00) for the guardianship account of Flo Dian Parker. Your petitioner believes that these sums are reasonable for said services. It is assumed that the attorney will not have to travel to Santa Ana in connection with this petition.

Final Account, Report and Petition for Distribution and Discharge of Guardian with respect to the Guardianship of Flo Dian Parker.

Flo Dian Parker was born August 1, 1929. She became twenty-one (21) years of age on August 1, 1950. She is married and her name is now Dian P. McDaniel and she is the mother of one child.

Periodical reports of this account have been filed with and approved by the Court, the final account ending July 31, 1950, being included herewith.

The balance in the account for Flo Dian Parker McDaniel is \$90,028.38 as shown above. Said balance consists of the items shown in Exhibit B attached hereto.

Except for the payment of attorney's fees herein requested (\$300.00 to Melvin D. Wilson, Esquire) and except for the settlement of the claims on account of income taxes (said claims having been filed

by Elgin R. Parker and Flo Parker), all other claims have been paid, and this guardianship is now in condition to be finally settled and distributed.

If the Court approves of the settlement of the claims filed by Elgin R. Parker and Flo Parker and aggregating \$38,563.25, and approves the payment of attorney's fees requested, the petitioner proposes to distribute to Flo Dian Parker McDaniel assets costing \$51,165.35, and to hold in the reserve for the compromise of said claims and the payment of \$300.00 attorney's fees, assets costing \$38,863.25, all as shown on Exhibit B.

Application For Authority to Compromise Claims

On July 30, 1948, this Court made an Order Settling Fourth Annual Account of Guardian and Order for Payment of Attorney's Fees and Order for Authority to Compromise Claims, etc.

The claims involved were claims by Elgin R. Parker and Flo Parker against each of the guardianship estates for adjustment on account of Federal and State income taxes and interest, which the parents have been compelled to pay by reason of the tax authorities refusing to treat the four wards as members of the partnership of Southern Heater Company, but instead taxed all of the income of said partnership to Elgin R. Parker and Flo Parker and greatly increased their income taxes thereby and they greatly increased the income taxes of the family by reason of such action.

In the order dated July 30, 1948, the Court authorized the guardian to use the refunds of State and Federal income taxes and interest payable to the children to assist the parents in paying their State and Federal income taxes and interest. The order further provided that if the parents eventually lost their income tax litigation, they would keep the refunds payable to the children and have permission to apply for further allowances. The order provided that if the parents were ultimately successful in their income tax litigation, they would return the refunds to the children, with any interest benefits received.

In view of the fact that Flo Dian Parker McDaniel has now attained her majority and is entitled to a distribution of her guardianship assets, it seems necessary to arrive at a more definite determination of the claims of Elgin R. Parker and Flo Parker.

The matter of the incidence of income tax on the income of the partnership known as Southern Heater Company is now pending before the United States Circuit Court of Appeals for the Ninth Circuit in appeals filed by Elgin R. Parker and Flo Parker from adverse verdicts and judgments in the United States District Court. It will be some months before said appeals are finally settled.

The additional State and Federal income tax and interest collected from Elgin R. Parker and Flo Parker, after giving effect to the refunds given to the four children involved in this proceeding for the period November 1, 1943, to the dissolution of

the partnership on October 31, 1948, was \$223,913.92 as shown by the Schedule of Income Tax Computations attached hereto.

If this additional tax and interest were to be prorated among the six partners in accordance with their interest in the partnership income, said additional burden would be distributed as follows:

Elgin R Parker and Flo Parker	\$ 69,805.64
The children, excepting Flo Dian	
Parker McDaniel	\$115,545.03
Flo Dian Parker McDaniel	38,563.25
	<hr/>
Total	\$223,913.92

It would seem equitable to distribute the additional income tax burden on the family in accordance with the distribution of the partnership income and your petitioner asks approval of the claims on that basis.

If the Court grants approval of said compromise, the \$38,563.25 prorated to Flo Dian Parker McDaniel will be retained in the guardianship estate until the outcome of the Federal income tax litigation. If the litigants are successful, Flo Dian Parker McDaniel will receive another \$38,563.25, plus additional interest. If the litigants are unsuccessful in their income tax litigation, Flo Dian Parker McDaniel will receive no further amounts from this guardianship estate.

Substantially the same result will apply to the other children when their guardianship assets are eventually distributed to them.

Wherefore, your petitioner prays approval of the compromise of the income tax claims of Elgin R. Parker and Flo Parker for the period November 1, 1943, to October 31, 1948, as set out above, and prays approval of the Sixth Annual Account as set out above, and prays approval of the Final Account and Report and Petition for Distribution of the Flo Dian Parker McDaniel guardianship, and prays approval of the authority to pay the attorney's fees in the amounts set out above.

Dated: Sept. 1, 1950.

ELGIN R. PARKER

Petitioner

/s/ MELVIN D. WILSON

Attorney for Petitioner

Duly Verified.

[Endorsed]: Filed Sept. 6, 1950.

SIGEN R. PARKER
STATE DEPT POLICIAN ACCOUNTS
November 1, 1943 to July 31, 1950.

Arthur L. Parker	Patriola	Flo Man	Rowland
Parker	Joe Parker	Parker	T. Parker
Total			

Balance in Accounts -
October 31, 1943

Balance in Accounts -									
October 31, 1943	353,339.69	30,339.92	39,339.91	39,339.93	39,339.93	39,339.93	39,339.93	39,339.93	39,339.93
<u>Income</u>									
5-2-49-1d-Valorem tax									
refund	182.07	30.88	39.58	30.81	30.81	30.81	30.81	30.81	30.81
6-3-49-Interest on savings									
Cooption Nat'l bank	2.43	.62	.48	.82	.82	.82	.82	.82	.82
12-3-49-Dividend Louthorn									
Water Corporation	17,500.00	4,375.00	4,375.00	4,375.00	4,375.00	4,375.00	4,375.00	4,375.00	4,375.00
12-3-49-Dividend Ass'n									
General Corporation	6,500.30	1,625.00	1,625.00	1,625.00	1,625.00	1,625.00	1,625.00	1,625.00	1,625.00
12-3-49-Interest on sav-									
ings Cooption Nat'l bank	6.98	1.67	1.67	1.27	1.27	1.27	1.27	1.27	1.27
6-3-49-Interest on sav-									
ings Cooption Nat'l bank	101.83	23.31	29.85	15.08	15.08	15.08	15.08	15.08	15.08
Total Income	27,232.03	6,061.82	6,081.36	6,347.45	6,347.45	6,347.45	6,347.45	6,347.45	6,347.45
Totals	377,591.72	94,401.54	94,401.54	94,397.39	94,397.39	94,397.39	94,397.39	94,397.39	94,397.39

Credits

12-31-1918 on partial
return of 7,500 lbs.

of Radiantair, Inc. cost			
\$7,500, rec'd 113.0) com-	7,485.00	1,871.25	1,871.25
plete liquidation.	83.15		53.15
5-2-49-Paid to Elian			
1-13-50-Payment of "ati-			
nated 1943 income tax	3,500.00	800.00	800.00
2-1-50-Payment of Guardian			
trust premiums	357.00	39.25	39.25
2-27-50-Payment of balance			
of 1949 income tax	453.34	175.36	-0-
5-13-50-Payment of "ati-			
nated 1943 income tax	4,900.00	1,200.00	1,200.00
5-13-50-Guardian bond			
premiums 1949	357.00	39.25	39.25
5-13-50-Federal stamp taxes	117.16	29.26	29.26
5-13-50-California income			
tax - 1943	109.65	49.83	49.83
5-13-50-Legal Fees and			
disbursements	306.70	76.68	76.67
Total Credits	<u>17,429.40</u>	<u>4,344.78</u>	<u>4,344.78</u>
Balance	360,182.32	90,056.73	90,056.73

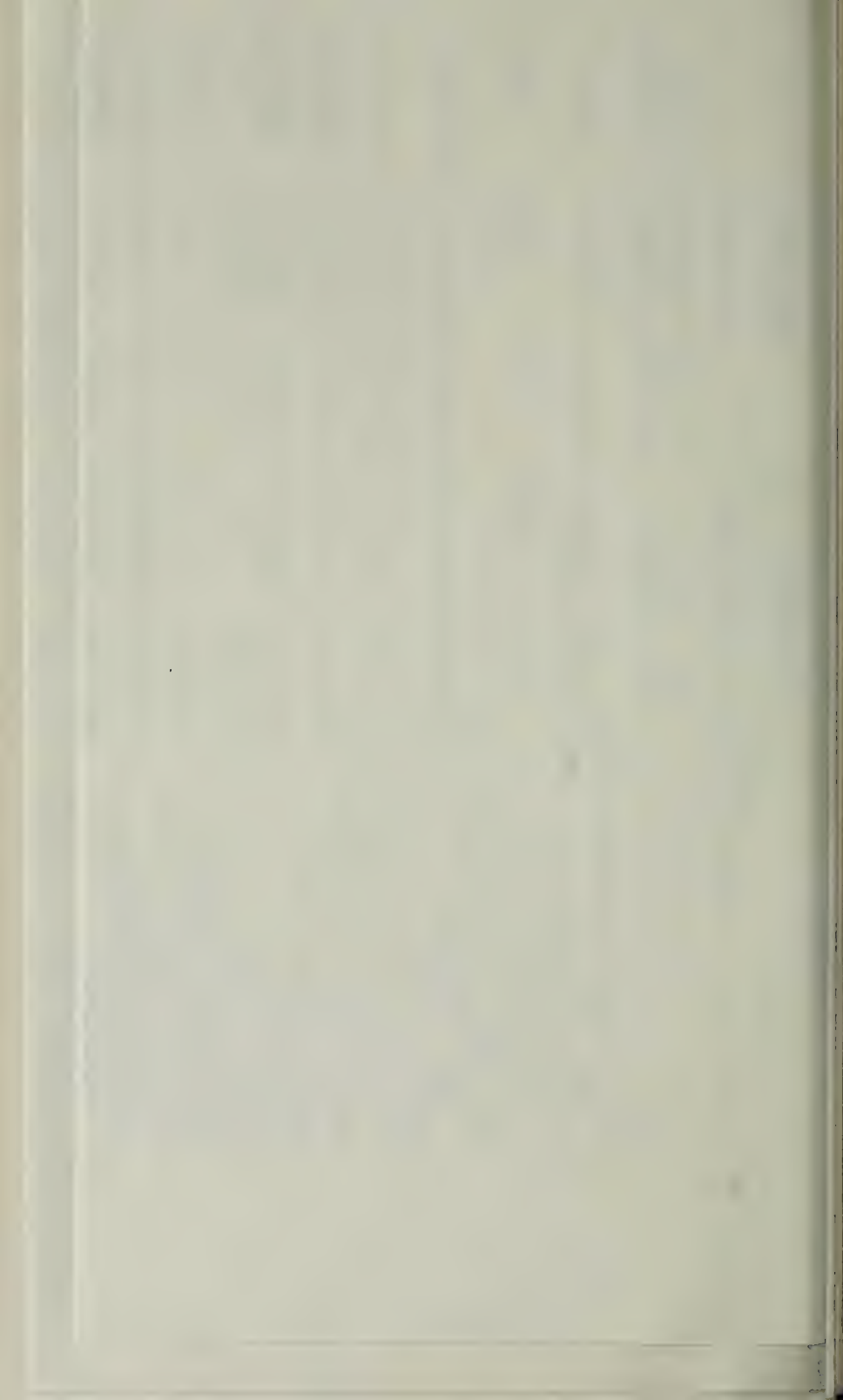
Further credits requested:
Attorney's fees, subject
to Court approval
Compliance of Claims of
Clinton D. Parker and Plo
Parker for income tax
adjustment

Total of Additional Credits

Balance

EXHIBIT B
DR. R. PARKER, GUARDIAN
ANALYSIS OF GUARDIANSHIP FUND
AS AT JULY 31, 1950

	<u>Total</u>	<u>Arthur G. Parker</u>	<u>Patricia Plo Dian Parker</u>	<u>Rowland T. Parker</u>
Cash in Bank - Compton Nat'l Bank	13,596.10	3,869.86	3,833.46	2,022.86
Accounts Receivable - Employees of Southern Heater Company	30.88	9.85	9.64	9.64
Notes Receivable - Dr. R. Parker and Plo Parker (4% - 10-29-50)	107,365.24	26,341.31	26,341.31	26,841.31
1,400 Shs. Southern Heater Corporation (At Cost)	170,111.36	49,527.84	42,527.84	42,527.86
240 Shs. American Control Corporation (At Cost)	26,300.00	6,500.00	6,500.00	6,500.00
290 Shs. Parker Realty Co. (At Cost)	29,000.00	7,250.00	7,250.00	7,250.00
Series "A" Bonds	15,000.00	3,750.00	3,750.00	3,750.00
4400 Street Lot	1,313.50	-0-	-0-	1,313.50
Loan Payable - Southern Heater Corporation	(357.00)	(39.25)	(39.25)	(39.25)
Customer's Credit Balance (Carried over from Southern Heater Company - Dissolved)	2,410.43	602.62	602.62	602.62
<u>Total Guardianship Fund - July 31, 1950</u>	<u>350,162.32</u>	<u>92,056.73</u>	<u>90,020.37</u>	<u>20,086.79</u>
Distribution to Plo Dian P. McDaniel				
350 Shs. Southern Heater Corporation	42,527.83			
65 Shs. American Control Corporation	6,550.00			
4400 Street Lot	1,313.50			
Cash	319.73			
<u>Total Distribution at this time</u>	<u>51,111.06</u>			
Held in Reserve for Compromise of Claims (333,563.95) and Attorney's Fees of .300.00.				
Cash in Bank - Compton Nat'l Bank (Before payment of \$300.00 Attorney's fees)	1,704.17			
Accounts Receivable - Employees of Southern Heater Corporation	9.64			
Notes Receivable - Dr. R. Parker and Plo Parker (4% - 10-29-50)	26,841.31			
725 Shs. of Parker Realty Company	7,250.00			
Series "A" Bonds	3,750.00			
Loans Payable - Southern Heater Corporation	(19.25)			
Customer's Credit Balance	(602.62)			
<u>Total held in Reserve</u>	<u>33,863.26</u>			
<u>Grand Total</u>	<u>920,089.36</u>			



PLAINTIFFS' EXHIBIT No. 58

SOUTHERN HEATER COMPANYBALANCE SHEETAs at November 1, 1943ASSETS

rent		
Cash on Hand and in Banks	48,191.95	
Accounts Receivable	64,281.33	
Merchandise Inventories:		
Materials and Supplies	76,679.69	
Finished Products	6,551.87	83,231.56
<u>Total Current Assets</u>		195,704.94

	Cost	Reserve for Depreciation and Replacement	Book Value
Land	20,101.58	--	20,101.58
Buildings	40,777.93	3,161.64	37,616.29
Machinery & Equipment	61,168.20	20,706.77	40,461.43
Shop Tools	3,938.92	2,319.14	1,619.68
Vehicles	5,433.77	3,948.38	1,485.39
Furniture & Fixtures	5,290.90	3,158.77	2,132.03
Delivery Equipment	2,924.32	2,539.90	384.42
	<u>139,635.42</u>	<u>35,834.60</u>	<u>103,800.92</u>

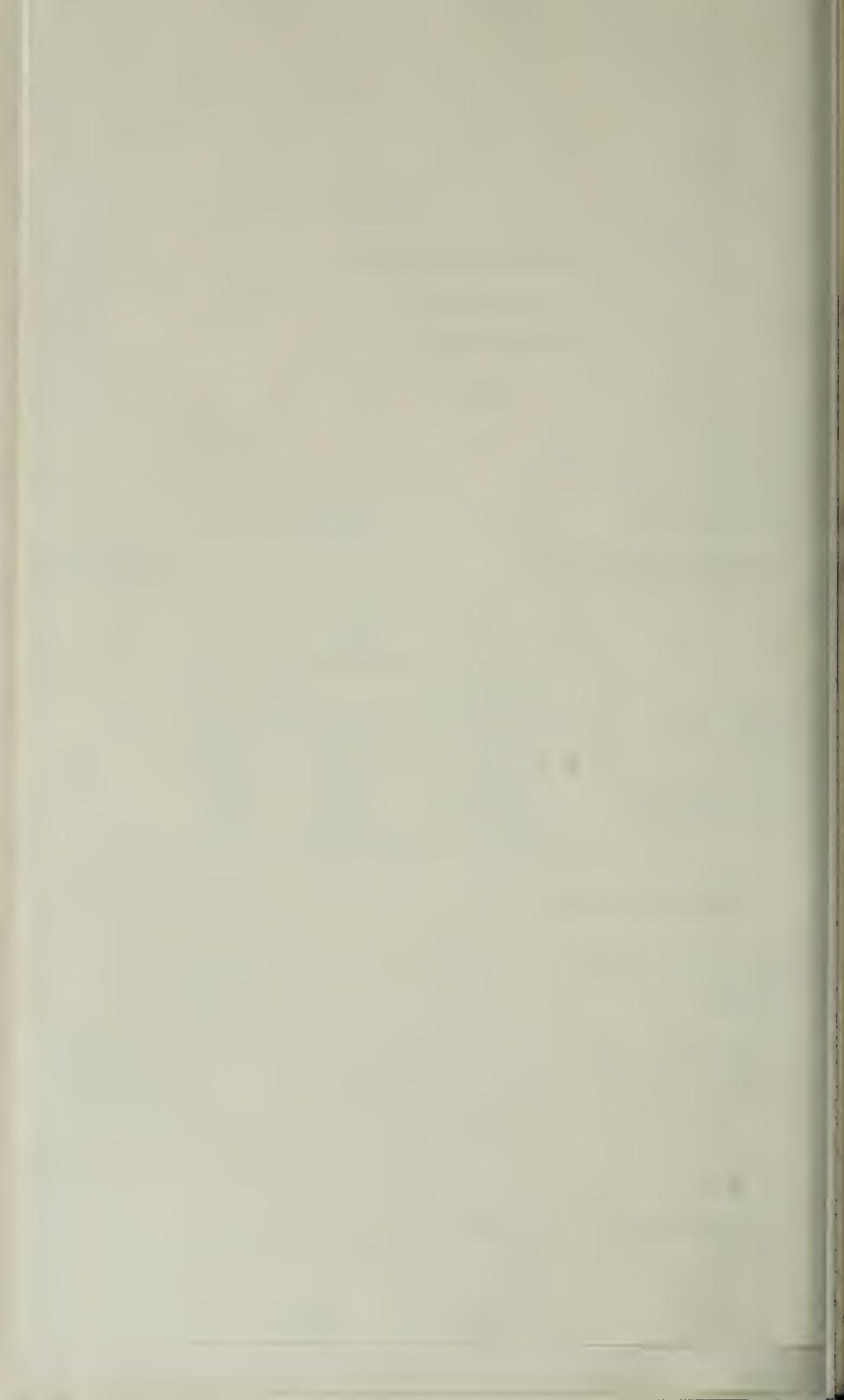
Total Fixed Assets 103,900.92

ier	
Mortgage Loan Receivable	9,075.00
Unexpired Insurance	2,483.34
Trade-Marks	205.20
Containers	309.00

Total Other Assets 12,072.54

TOTAL ASSETS 311,578.20

(Prepared from books and records without verification)



LIABILITIES AND CAPITAL

<u>Current Liabilities</u>	
Accounts Payable	12,729.57
Accrued Salaries and Wages	16,482.45
Accrued Commissions	4,345.15
Accrued Taxes Payable	18,542.73
Employees' Bond Reserve	273.17
Partners' Individual Federal Income Taxes Payable	36,443.20
Salary Payable - E. R. Parker	<u>7,364.63</u>

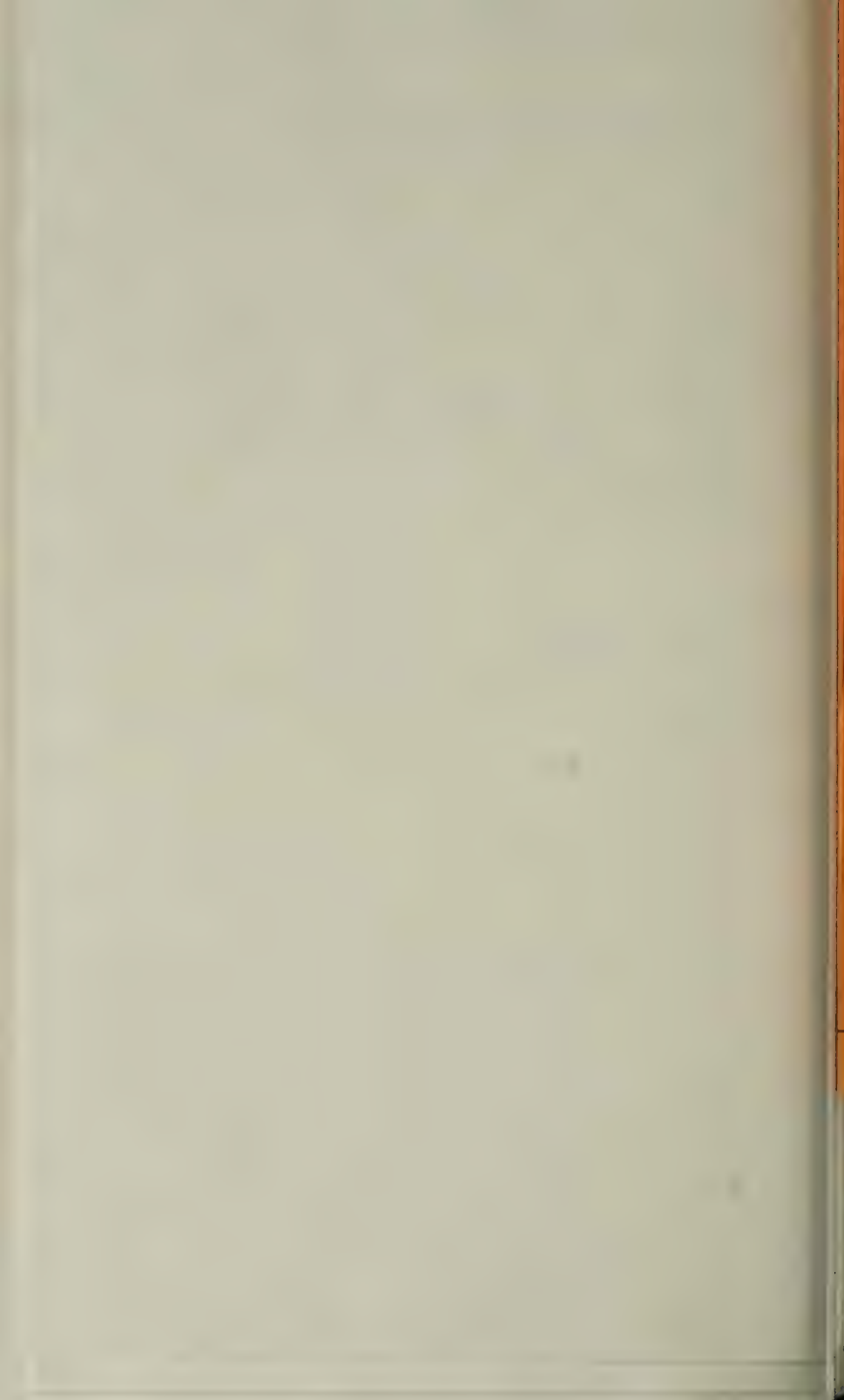
Total Current Liabilities 96,690.90

Provision for Service Charges 16,917.50

<u>Capital</u>	
Elgin R. Parker	\$49,492.94
E. R. Parker	49,492.94
Arthur Elgin Parker Guardianship	24,745.98
Ericia Lee Parker Guardianship	24,745.98
Dian Parker Guardianship	24,745.98
Wland Tibbetts Parker Guardianship	<u>24,745.98</u>

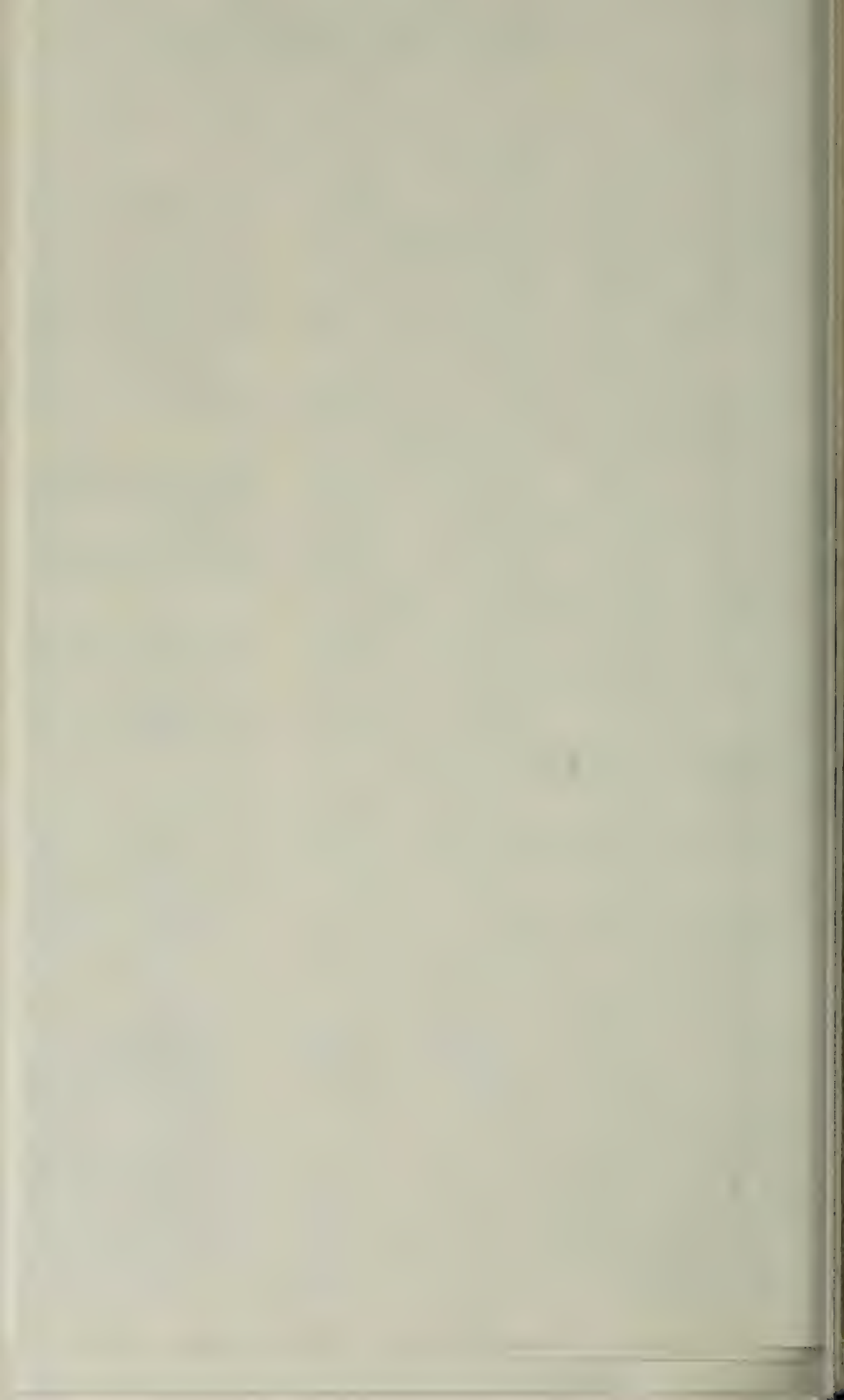
Total Capital 197,969.30

TOTAL LIABILITIES AND CAPITAL 311,578.20



SOUTHERN HEATER COMPANY
ANALYSIS OF PARTNERS' CAPITAL ACCOUNTS
November 1, 1943 to October 31, 1948

	E. R. Parker, Guardian						
	Total	E. R. Parker	Flo Parker	Arthur E. Parker	Patricia Les Parker	Flo Dian Parker	Rowland T. Parker
Beginning Capital - November 1, 1943	197,467.80	16,191.94	19,191.94	21,745.98	21,745.98	21,745.98	21,745.98
November 1, 1943 to October 31, 1944							
Add: Net Profit	252,535.82	63,133.95	63,133.95	31,566.98	31,566.98	31,566.98	31,566.98
	450,503.62	112,625.89	112,625.89	56,312.96	56,312.96	56,312.96	56,312.96
Less: Withdrawals for Income Tax	130,263.12	35,506.48	35,506.48	14,812.54	14,812.54	14,812.54	14,812.54
Other Withdrawals	3,506.14	980.70	2,065.44	115.00	115.00	115.00	115.00
	133,769.26	36,187.18	37,571.92	14,927.54	14,927.54	14,927.54	14,927.54
Capital - October 31, 1944	316,734.36	76,138.71	75,053.97	41,385.42	41,385.42	41,385.42	41,385.42
November 1, 1944 to October 31, 1945							
Add: Net Profit	217,646.15	54,411.54	54,411.53	27,205.77	27,205.77	27,205.77	27,205.77
	534,380.51	130,550.25	129,465.50	68,591.19	68,591.19	68,591.19	68,591.19
Less: Withdrawals for Income Tax	118,594.94	39,611.46	37,260.48	10,423.25	10,423.25	10,423.25	10,423.25
Other Withdrawals	15,486.70	243.35	243.35	3,750.00	3,750.00	3,750.00	3,750.00
	134,081.64	39,854.81	37,503.83	14,173.25	14,173.25	14,173.25	14,173.25
Capital - October 31, 1945	400,298.87	90,695.44	91,961.67	54,417.94	54,417.94	54,417.94	54,417.94
November 1, 1945 to October 31, 1946							
Add: Net Profit	300,783.48	75,195.86	75,195.86	37,597.94	37,597.94	37,597.94	37,597.94
	701,082.35	165,861.30	167,157.53	92,015.88	92,015.88	92,015.88	92,015.88
Less: Withdrawals for Income Tax	111,733.37	50,678.44	50,517.17	2,634.44	2,634.44	2,634.44	2,634.44
Other Withdrawals	9,166.30	1,226.40	7,582.90	89.25	89.25	89.25	89.25
	120,899.67	51,904.84	58,100.07	2,723.69	2,723.69	2,723.69	2,723.69
Capital - October 31, 1946	580,182.68	113,956.46	109,057.46	89,292.19	89,292.19	89,292.19	89,292.19
November 1, 1946 to October 31, 1947							
Add: Net Profit	24,296.66	6,074.17	6,074.17	3,037.08	3,037.08	3,037.08	3,037.08
	604,479.34	120,030.63	115,131.63	92,329.27	92,329.27	92,329.27	92,329.27
Less: Withdrawals for Income Tax	111,590.26	22,500.53	22,500.67	16,647.27	16,647.27	16,647.26	16,647.26
Other Withdrawals	19,503.50	9,817.75	10,042.75	89.25	89.25	89.25	89.25
	92,086.76	12,682.78	12,157.92	16,736.52	16,736.52	16,736.51	16,736.51
Capital - October 31, 1947	512,392.58	107,347.85	102,673.71	75,592.75	75,592.75	75,592.76	75,592.76
Payment on Tax Deficiency	61,066.72	31,594.00	32,132.72	-	-	-	-
Adjusted Capital - October 31, 1947	448,325.86	75,113.85	70,540.99	75,592.75	75,592.75	75,592.76	75,592.76
November 1, 1947 to October 31, 1948							
Add: Net Profit	75,229.12	18,807.28	18,807.28	9,103.64	9,103.64	9,103.64	9,103.64
	523,554.98	94,221.13	89,348.27	84,696.39	84,696.39	84,696.40	84,696.40
Less: Withdrawals for Income Tax	4,818.05	768.07	882.37	695.90	695.90	695.90	695.90
Other Withdrawals	56,748.04	29,144.88	29,144.88	289.43	289.43	289.43	289.43
	61,566.09	29,912.95	30,027.25	406.47	406.48	406.47	406.47
Capital - October 31, 1948							
(Before Issuance of Notes)	461,988.89	64,308.18	59,321.02	84,589.92	84,589.91	84,589.93	84,589.93
Add: Partners' Notes	214,730.68	104,871.66	109,858.82	-	-	-	-
Capital - October 31, 1948	676,719.57	169,179.84	169,179.84	84,589.92	84,589.91	84,589.93	84,589.93
Distribution to Partners - October 31, 1948							
(Per Schedule Attached)	676,719.37	169,179.84	169,179.84	84,589.92	84,589.91	84,589.93	84,589.93
Balance	-	-	-	-	-	-	-



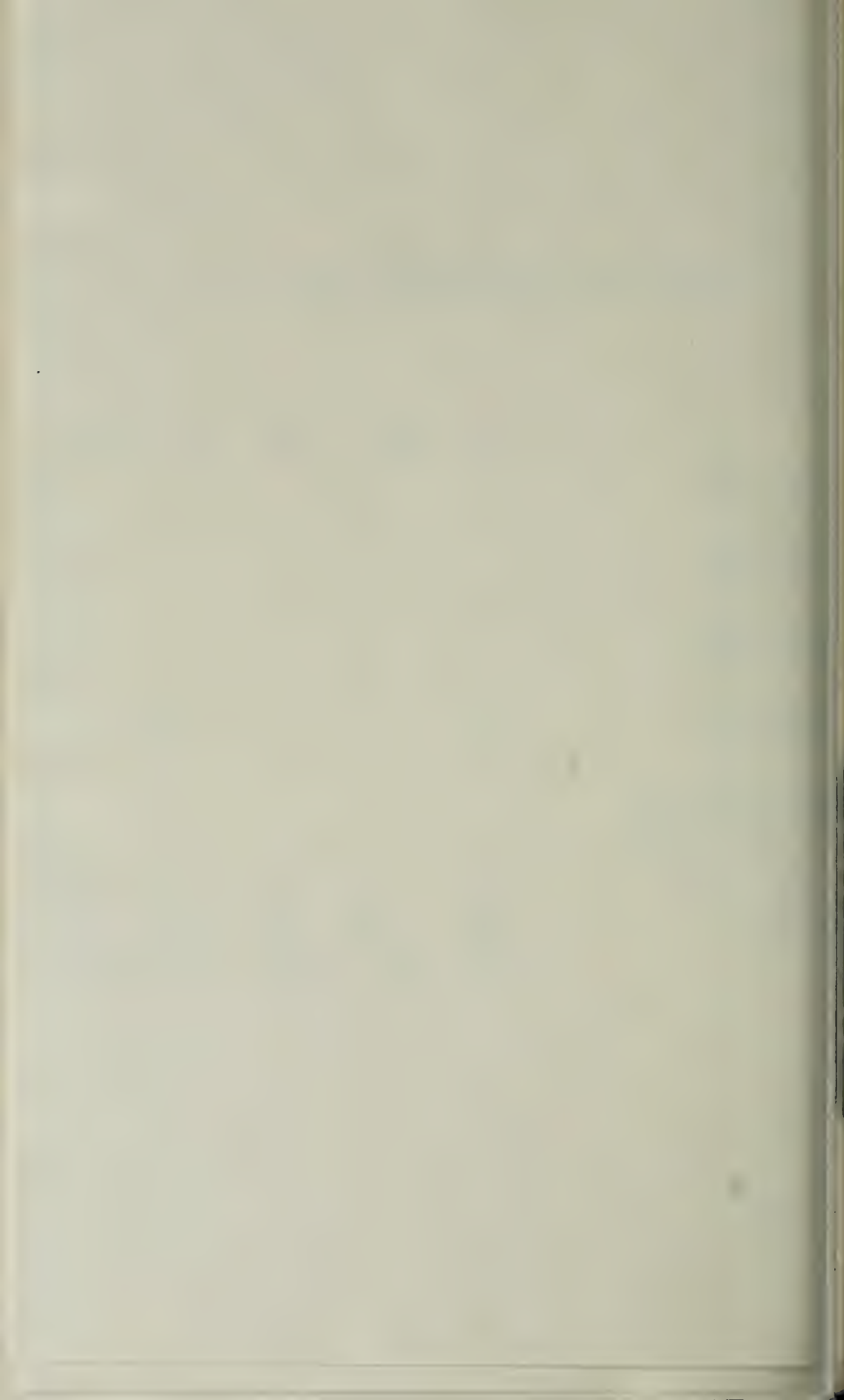
Plaintiffs' Exhibit No. 60--(Continued)

E. R. PARKER, GUARDIAN

DISBURSEMENTS FROM GUARDIANSHIP FUNDS - OTHER THAN INCOME TAXES

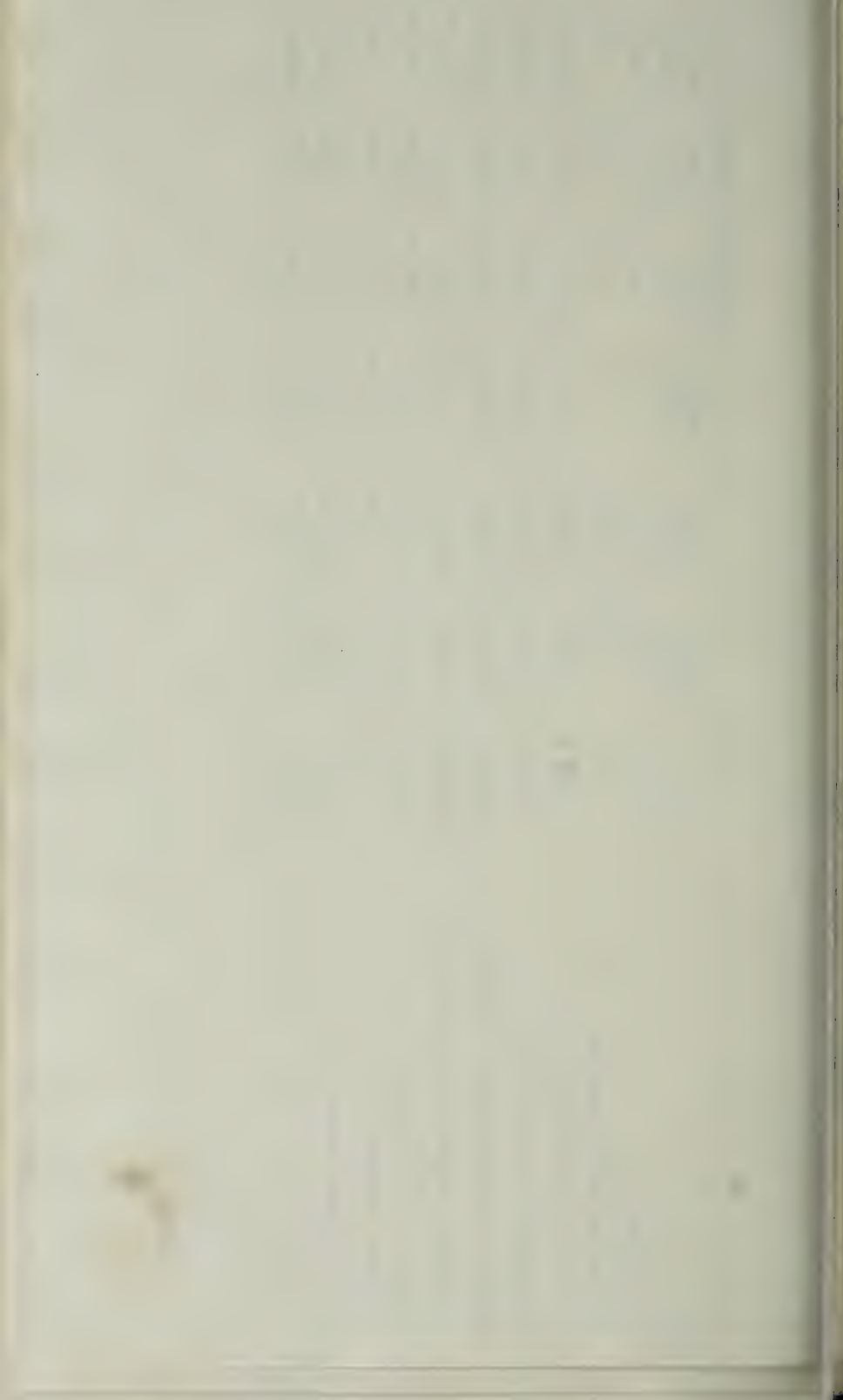
November 1, 1943 to October 31, 1948

	<u>Total</u>	<u>Arthur E. Parker</u>	<u>Patricia Lee Parker</u>	<u>Flo Dian Parker</u>	<u>Rowland T. Parker</u>
<u>ember 1, 1943 to</u> <u>October 31, 1944</u> Guardian Bond	460.00	115.00	115.00	115.00	115.00
<u>ember 1, 1944 to</u> <u>October 31, 1945</u> Series E Bonds	15,000.00	3,750.00	3,750.00	3,750.00	3,750.00
<u>ember 1, 1945 to</u> <u>October 31, 1946</u> Guardian Bond	357.00	89.25	89.25	89.25	89.25
<u>ember 1, 1946 to</u> <u>October 31, 1947</u> Guardian Bond	357.00	89.25	89.25	89.25	89.25
<u>ember 1, 1947 to</u> <u>October 31, 1948</u> Partnership Adjustments: Adjustment of 10/31/47 Reserve for Service Charges Return of Edison Co. Deposit Guardian Bond Legal Fees	1,584.00 332.84 357.00 402.12 <u>15,016.28</u>	396.00 83.21 89.25 100.53 <u>3,754.07</u>	396.00 83.21 89.25 100.53 <u>3,754.07</u>	396.00 83.21 89.25 100.53 <u>3,754.07</u>	396.00 83.21 89.25 100.53 <u>3,754.07</u>



	Total	E. R. Parker, Guardian			
		Arthur E. Parker	Patricia Lee Parker	Flo Dian Parker	Rowland T. Parker
Cash in Bank	1,328.88	166.11	166.11	166.11	166.11
Accounts Receivable - Employees	77.16	9.65	9.64	9.64	9.65
Notes Receivable from Partners	214,750.48	26,841.31	26,841.31	26,841.31	26,841.31
Investment in Radiantair, Inc.	15,000.00	1,875.00	1,875.00	1,875.00	1,875.00
Investment - Southern Heater Corporation	340,222.76	42,527.84	42,527.84	42,527.85	42,527.85
Investment - American Control Corporation	52,000.00	6,500.00	6,500.00	6,500.00	6,500.00
Investment - Parker Realty Co.	58,000.00	7,250.00	7,250.00	7,250.00	7,250.00
Tax Refund Receivable	181.05	22.63	22.63	22.64	22.63
Customers' Credit Balances	4,820.96	602.62	602.62	602.62	602.62
Partnership Capital	676,719.37	84,589.92	84,589.91	84,589.93	84,589.93

Final amount, 1930



PLAINTIFFS' EXHIBIT No. 63

COMMISSIONER OF INTERNAL REVENUE STATISTICS OF INCOME

Published under the authority of Section 63 of the Internal Revenue Code of 1939. Compiled from Income Tax Returns of corporations, with net income, filing balance sheets.

(Figures in Thousands of Dollars)

IRON, STEEL AND PRODUCTS (MANUFACTURING CORPORATIONS)

Number of Companies	Sales	Net Income after compensation of officers but before income tax	Net Worth	Compensation of Officers	Page of Report
4982	\$16,387,852	\$1,280,083	\$9,124,282	\$190,759	152
5539	12,066,371	1,094,519	7,234,238	190,592	154

PERCENTAGE OF COMPENSATION TO:

Sales	Net Income
1.10	14.90
1.50	17.00

NON FERROUS METALS AND THEIR PRODUCTS (MANUFACTURING CORPORATIONS)

1814	\$ 3,716,535	\$ 275,562	\$2,138,736	\$ 55,680	153
2348	3,871,459	381,362	2,335,469	68,038	156

PERCENTAGE OF COMPENSATION TO:

Sales	Net Income
1.50	20.00
1.70	17.00

SOUTHERN HEATER COMPANY (Figures in Dollars)

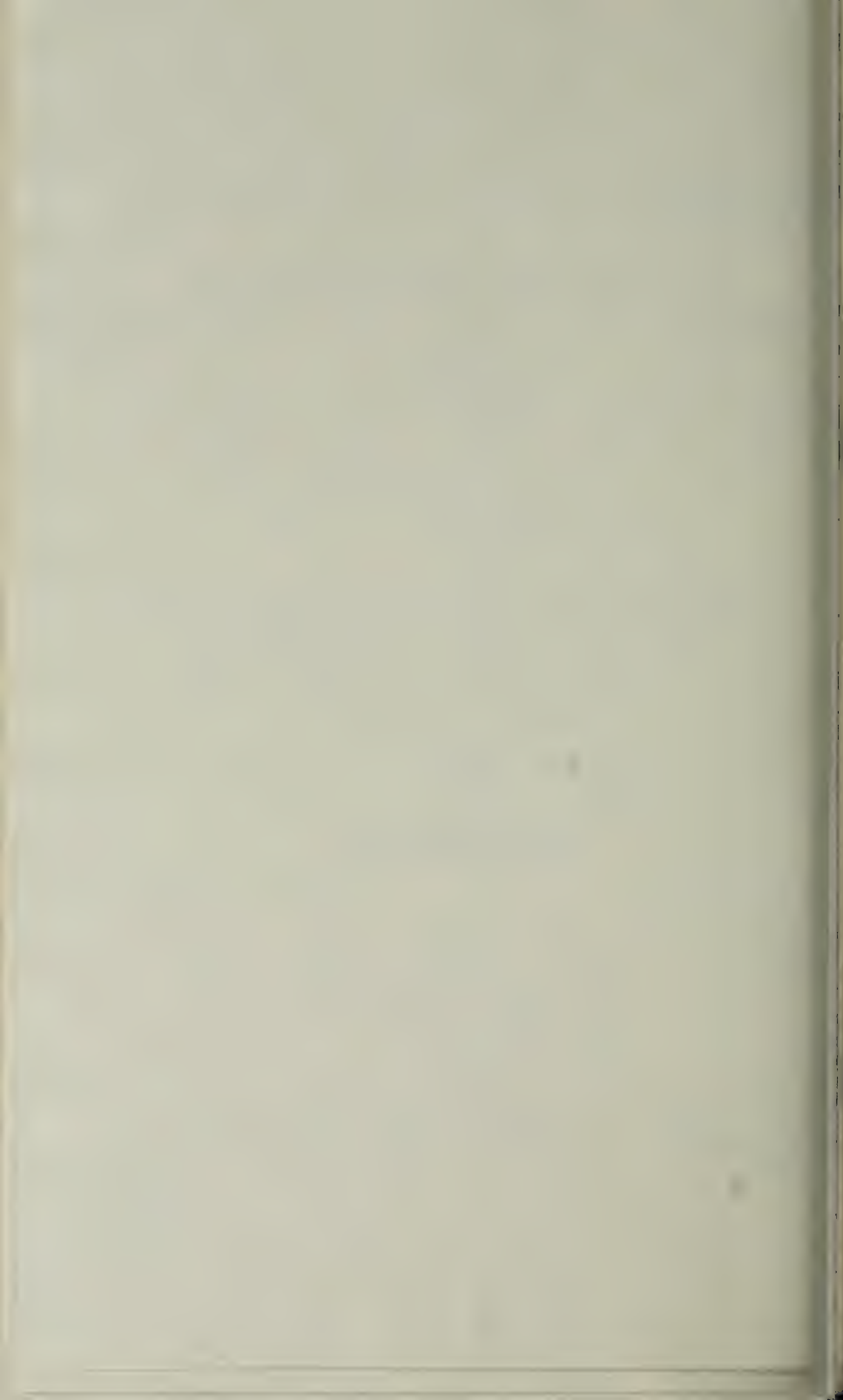
cal year ended 10-31-45	\$ 1,526,850	\$ 217,646	\$ 400,298	\$ 24,500*
months ended 4-30-46	1,094,330	300,783	580,182	14,000*

PERCENTAGE OF COMPENSATION TO:

Sales	Net Income
1.60	11.00
1.28	4.65

1945 G. McGaughey received \$7,000.00 and C. Fierke \$5,500.00

1946 (six months) G. McGaughey received \$4,500.00 and C. Fierke \$5,500.00.



CERTIFICATE OF ASSESSMENTS AND PAYMENTS

OF COLLECTOR OF INTERNAL REVENUE
Sixth-Calif.

In re: **Algia Parker**
Box 629, Compton, Calif.

COMMISSIONER OF INTERNAL REVENUE:
ATTENTION:

(Refer to certificate and date of letter requesting this transcript)

The following is a transcript of the records of this office covering the accounts of the taxpayer named
Income

in respect to

1945-1946

(Character of tax)

(Period covered)

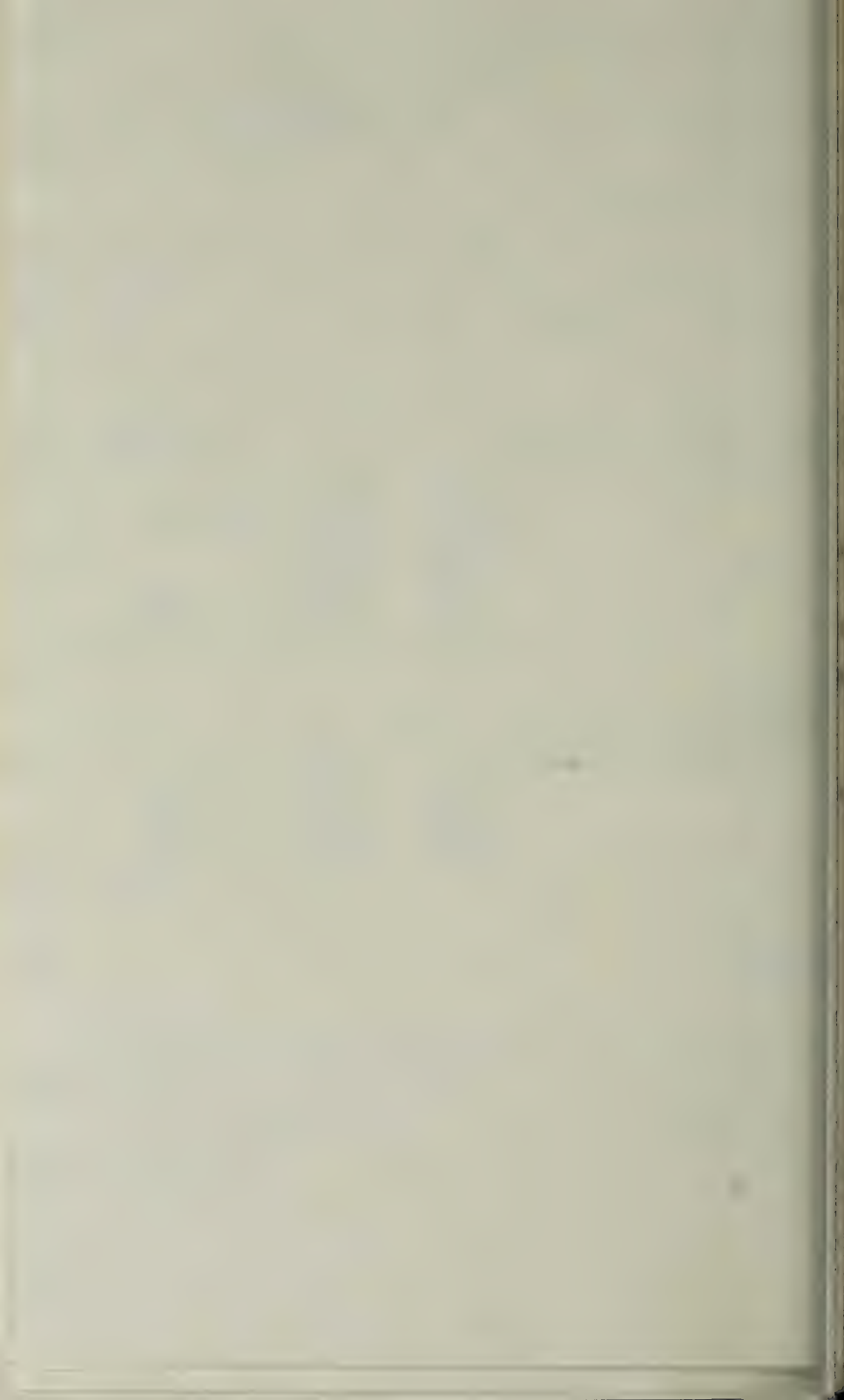
2. LIST AND YEAR	3. ACCT. NO. OR PAID AND LINE	4. AMOUNT ASSESSED	PAID, ABATED, OR CREDITED		7. PAID AB. CR.	8. ADJUSTMENT OF OVERASSESSMENTS
			5. DATE OR SCHEDULE NO.	6. AMOUNT		
7/49	519047	46,401 28				1040 3002244
Int. to 7/15/49)		9,280 26				272C RAR
			2/28/49	26,053 22	Pd	
			8/3/49	16,636 15	Pd	
			9/19/49	597 10	Abt. Sch. 1079	
			12/2/49	2,000 00	Pd	
			1/19/50	2,000 00	Pd	
			2/17/50	2,000 00	Pd	
			3/31/50	3,196 53	Cr. Cl. 158096	
			3/31/50	3,196 54	Cr. Cl. 158096	
		I 1 00	5/31/50	1 00	Tr. to 7-531926-50	
23C 7/15/49						
DAR 7/18/49						
17 7/20/49						
7/49	519048	61,079 27				1040 3034491 272C
Int. to 7/15/50)		8,551.10				
			2/28/49	26,053 22	Pd. RAR	
			9/19/49	598 10	Abt. Sch. 1079	
			3/31/50	13,100 64	Cr. Cl. 158096	
			3/31/50	13,100 63	Cr. Cl. 158096	
			3/31/50	13,100 65	Cr. Cl. 158096	
			3/31/50	3,675 13	Cr. Cl. 158096	
		I 1 00		1 00	Tr. to 7-531927-50	
13C 7/15/49						
DAR 7/18/49						
17 7/20/49						

CERTIFY that the foregoing transcript of the accounts of the taxpayer named above in respect to the specified, is true and complete for the period stated, and that all assessments and payments of tax, and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office, are shown therein.

Certificate Oct. 24, 1952 R. A. Riddell

(See instructions on reverse side)

Collector of Internal Revenue.



Form 100
BUREAU OF INTERNAL REVENUE

PLAINTIFFS' EXHIBIT No. 64-B

CERTIFICATE OF ASSESSMENTS AND PAYMENTS

OFFICE OF COLLECTOR OF INTERNAL REVENUE

Sixth-Calif.

Elgin Parker

Box 629, Compton, Calif.

THE COMMISSIONER OF INTERNAL REVENUE:

ATTENTION:

The following is a transcript of the records of this office covering the accounts of the taxpayer named
ESTIMATED - INCOME

in respect to

1945 - 1946

(Character of tax)

(Period covered)

PAID, CREDITED, OR DEFERRED

1. LIST AS YEAR	2. ACCOUNT OR PAYMENT NO.	3. AMOUNT ASSESSED	4. DATE OF PAYMENT OR CREDIT	5. AMOUNT	6. PAYMENT METHOD	7. PAYMENT NO.
1945	1115927	T 41,500 00 (Old Balance)	7/7/45 9/17/45	10,375 00 10,375 00 10,375 00 10,375 00	Pd Pd Pd Pd	5106401 5272728
1945	3002244	T 4,497 85	Mar. 1946	4,497 85	Pd	
1946	1111868	T 20,000 00	7/2/46 11/4/46 2/18/47	5,000 00 12,000 00 18,000 00 8,700 00 23,700 00	Pd Pd Pd Pd Bal.	6/7/46 1900455 9/15/46 1922574 1/15/47 1958068
1946	3034691	5,168 13	3/15/47	5,168 13	Pd	

Prepayment by Withholding from wages:

Form 942 - Year 1946

Employer	Employee	Tax Withheld
Southern Heater Corp.	E.R. Parker	2,209 15
American Control Corp.	E.R. Parker	791 00
		2,600 15
	1/2 community share	1,300 00

CERTIFY that the foregoing transcript of the accounts of the taxpayer named _____ of the _____ specified, is true and complete for the period stated, and that all assessments and payments of tax, by and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office are shown therein.

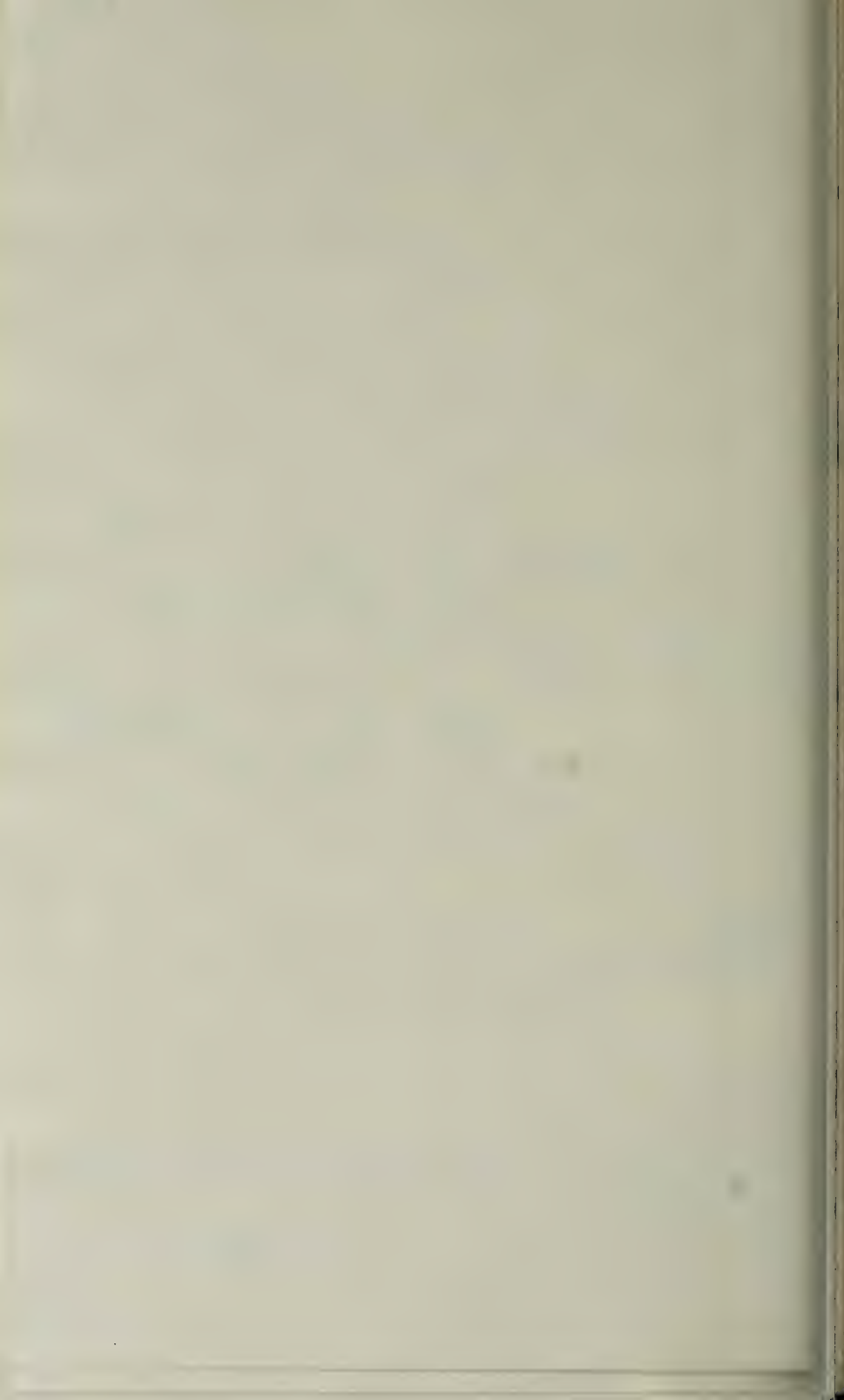
Oct. 24

52

R. A. KIDWELL

of certificate

19
(See instructions on reverse side)



CERTIFICATE OF ASSESSMENTS AND PAYMENTS

OFFICE OF COLLECTOR OF INTERNAL REVENUE

In re: **Flo Parker**DISTRICT OF **Math. Calif.**

(Name of taxpayer)

Box 629, Compton, Calif.

(Address)

THE COMMISSIONER OF INTERNAL REVENUE:

ATTENTION:

(Refer to symbols and date of letter requesting this certification)

The following is a transcript of the records of this office covering the accounts of the taxpayer named

in respect to **Income**

(Character of tax)

for the **1945 - 1946**

(Period covered)

1. LAST AND YEAR	2. ACCT. NO. OR PAGE AND LINE	3. AMOUNT ASSESSED	PAID, ABATED, OR CREDITED		7. PAID AS CR.	8. ADJUSTMENT OF OVERASSESSMENTS
			5. DATE OR SCHEDULE NO.	6. AMOUNT		
7/49	519049	T 46,814 65				1040 3002249
(Int. to 7/15/49)		I 9,362 93				2720 RAR
			8/3/49	16,709	27 Pd	
			2/28/49	26,261	91 Pd	
			9/19/49	601	84 Abt.	Sch. 1079
			12/2/49	2,000	00 Pd	
			1/19/50	2,000	00 Pd	
			2/17/50	2,000	00 Pd	
			3/31/50	3,302	28 Cr.	Cl. 158896
			3/31/50	3,302	28 Cr.	Cl. 158896
		I 1 00		1 00		
7/49	519050	T 61,079 28				
(Int. to 7/15/50)		I 8,551 10				
			2/28/49	26,261	91 Pd	
			9/19/49	601	84 Abt.	Sch. 1079
			3/31/50	8,282	16 Cr.	Cl. 158896
			3/31/50	8,282	16 Cr.	Cl. 158896
			3/31/50	9,425	52 Cr.	Cl. 158896
			3/31/50	8,387	90 Cr.	Cl. 158896
			3/31/50	8,387	91 Cr.	Cl. 158896
		I 1 00		1 00		
23C 7/15/49						
PAR 7/18/49						
17 7/20/49						

I CERTIFY that the foregoing transcript of the accounts of the taxpayer named above in respect to the specified, is true and complete for the period stated, and that all assessments and payments of tax, interest, and all abatements, credits, and refunds relating thereto as disclosed by the records in this office, are shown therein.

Date of certificate **Oct. 31**, 19**48****E. A. RICHIE**

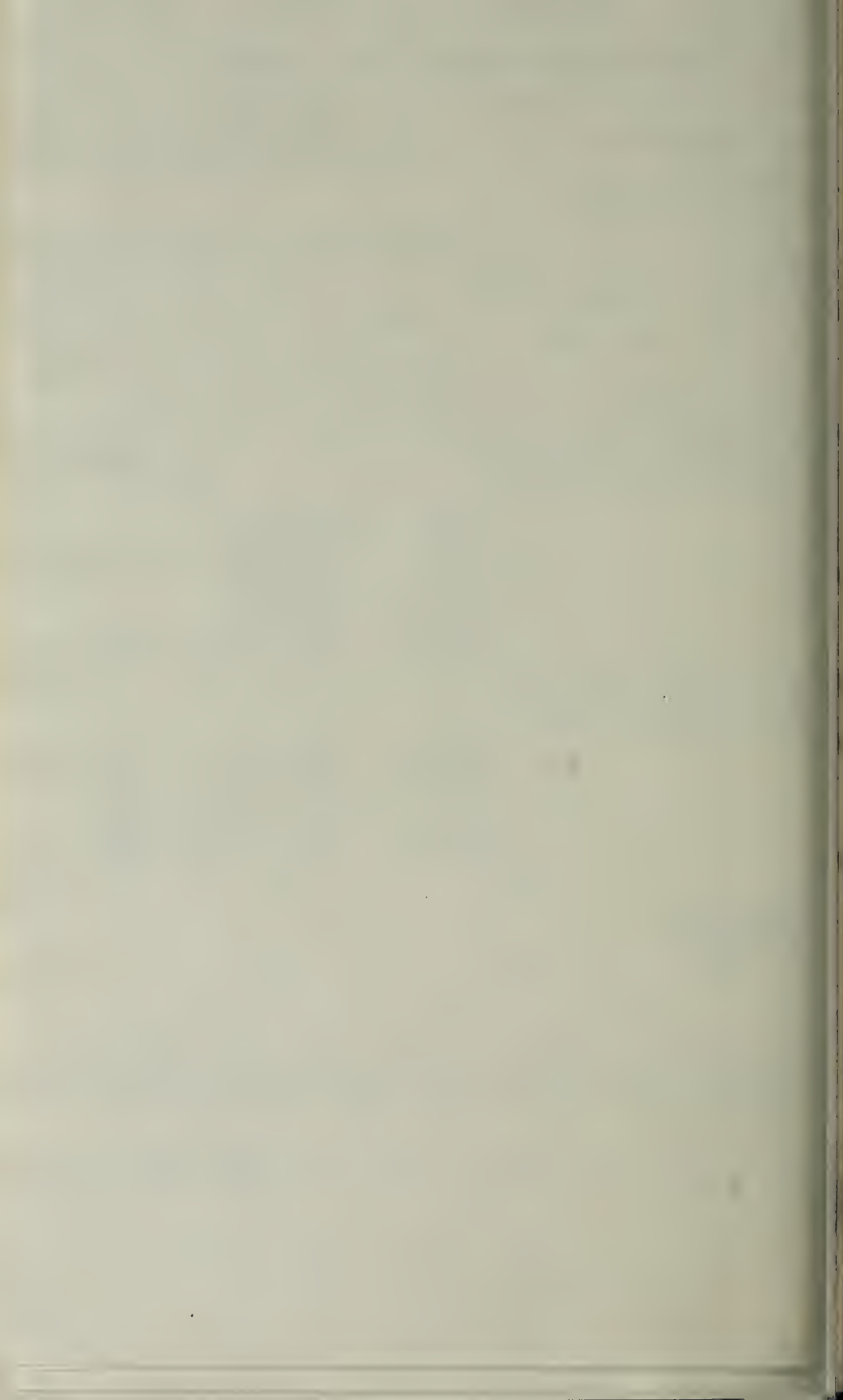
GOVERNMENT PRINTING OFFICE

16-13004

(See instructions on reverse side)

Collector of Internal Revenue.

C.T.)



PLAINTIFFS' EXHIBIT No. 64-D

CERTIFICATE OF ASSESSMENTS AND PAYMENTS

OFFICE OF DISTRICT DIRECTOR OF INTERNAL REVENUE

In re: Flo ParkerCITY OF Santh-Calif.

(Name of taxpayer)

Box 629, Compton, Calif.

(Address)

THE COMMISSIONER OF INTERNAL REVENUE:

ATTENTION:

(Refer to symbols and date of letter requesting this certification)

The following is a transcript of the records of this office covering the accounts of the taxpayer named

in respect to **ESTIMATED AND INCOME**

(Character of tax)

for the 1945 - 1946

(Period covered)

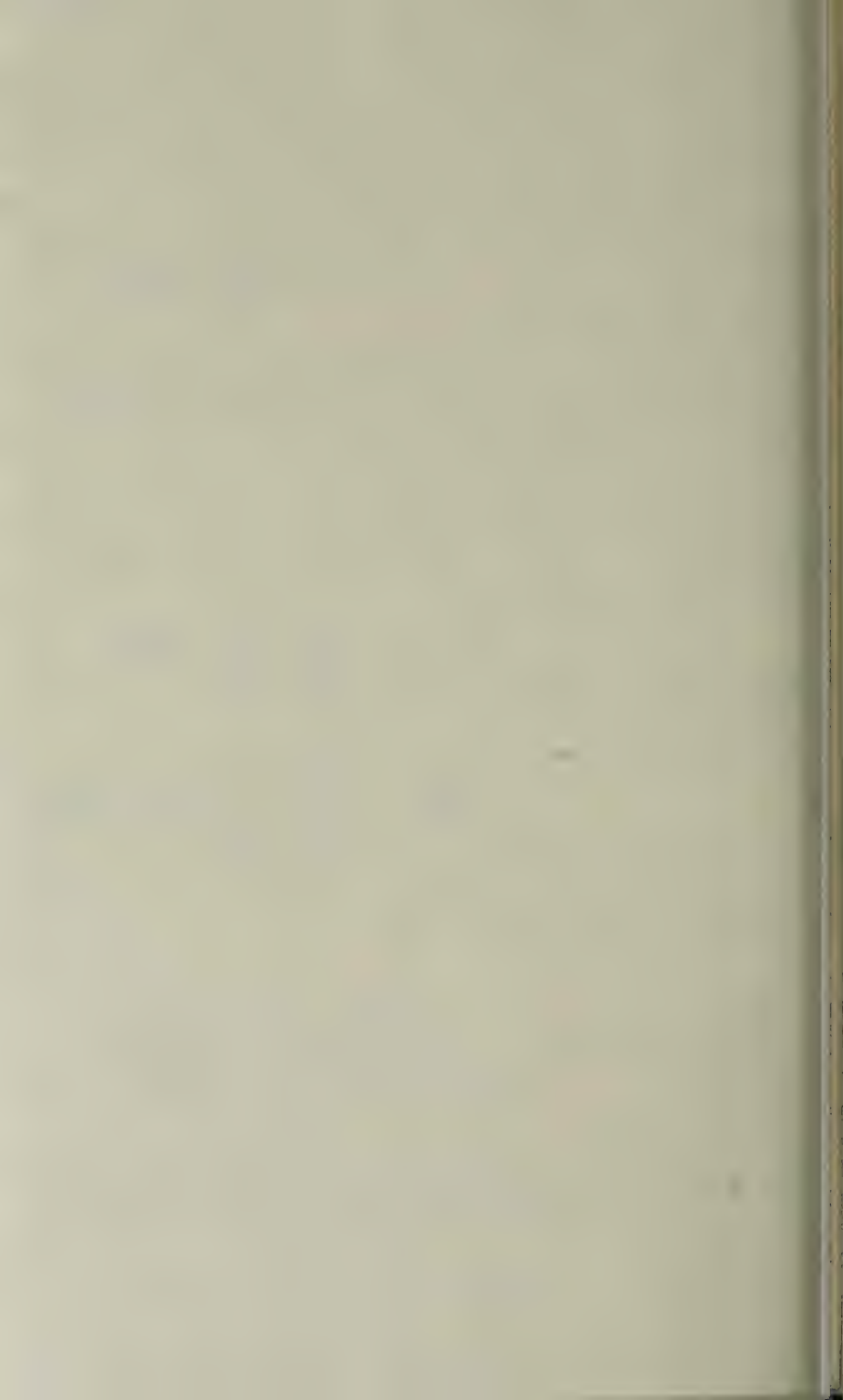
1. LIST AND YEAR	2. ACCT. NO. OR PAGE AND LINE	4. AMOUNT ASSESSED	PAID, ABATED, OR CREDITED		7. PAID AS. CR.	8. ADJUSTMENT OF OVERASSESSMENTS
			5. DATE OR SCHEDULE NO.	6. AMOUNT		
1945	1113926 T	41,500 00 (Old Balance)				
			7/7/45	10,375 00	Pd	
			9/17/45	10,375 00	Pd	5016385
				10,375 00	Pd	5272727
				10,375 00	Bal.	
1945	3002249 T	4,336 58	Mar. 1946	4,336 58	Pd	
1946	1103536 T	20,000 00				
			7/2/46	5,000 00	Pd	
			10/25/46	12,000 00	Pd	6/7/46 1900454
			2/18/47	18,000 00	Pd	9/16/46 1919125
				8,700 00	Pd	1/15/47 1958047
				23,700 00	Bal.	
1946	3034692 T	5,168 27	3/15/47	5,168 27	Pd	
Prepayment by Withholding from Wages:						
Forms W-2 - Year 1946						
<u>Employer</u>			<u>Employee</u>			<u>Tax Withheld</u>
Southern Heater Corp.			E. R. Parker			2,209.15
American Control Corp.			E. R. Parker			391.00
			1/2 community share			2,600.15
						1,300.07

CERTIFY that the foregoing transcript of the accounts of the taxpayer named above in respect to the specified, is true and complete for the period stated, and that all assessments and payments of tax, and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office, are shown therein.

Certificate of Sept. 2419 46
(See instructions on reverse side)E. A. AINELL

Collector of Internal Revenue.

(COPY)



PLAINTIFFS' EXHIBIT No. 64-E

Certificate of Assessments and Payments

Office of District Director of Internal Revenue, Los Angeles, California.

To: Chief Counsel, Washington 25, D. C.

In Re: (Name of Taxpayer) Elgin R. & Flo Parker, 120 So. Burris Ave., Compton, Calif., Or:—Box 629, Compton, California.

Attention: CC:M, September 22, 1955.

The following is a transcript of the records of this office covering the accounts of the taxpayer named above in respect to (character of tax): Estimated Tax. For the (period covered): Years—1947 and 1948.

1.	2.	3.	<u>Paid, Abated, or Credited</u>		7.	8.
Taxable Period	List and Year	Acct. No. Or Page and Line	5. Date or Sched. No.	6. Amount	Paid AB. CR.	Adjustment of Overassessments
1947	1947L	1119749	No Date	3,000.00	Pd.	
			6/16/47	3,000.00	Pd.	
			9/15/47	3,000.00	Pd.	
						(Elgin)
1948	1948L	1821406				Cr. of \$2,706.51
(Joint)						Schedule #7468
						7/28/48 on 1947 IT
						Acct. No. 5991383
						(Flo)
						Cr. of \$2,767.18
						Schedule #7468
						7/28/48 on 1947 IT
						Acct. No. 5991384

I certify that the foregoing transcript of the accounts of the taxpayer named above in respect to the taxes specified, is true and complete for the period stated, and that all assessments and payments of tax, penalty and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office are shown therein.

Date of Certificate: October 24, 1955.

District Director of Internal Revenue R. A. Riddell.

U. S. Treasury Department—Internal Revenue Service Code 1126:NN (1232:NN).

PLAINTIFFS' EXHIBIT No. 64-F

Certificate of Assessments and Payments

Office of District Director of Internal Revenue, Los Angeles, California.

To: Chief Counsel, Washington 25, D. C.

In Re: (Name of Taxpayer) Elgin R. Parker, 120 So. Burris Ave., Compton, Calif., or Box 629, Compton, California.

Attention: CC:M, September 22, 1955.

The following is a transcript of the records of this office covering the accounts of the taxpayer named above in respect to (character of tax): Income. For the (period covered): Years—1947 & 1948.

1. Taxable Period	2. List and Year	3. Acct. No. Or Page and Line	4. Amount Assessed	Paid. Abated. or Credited		7. Paid AB. CR.	8. Adjustment of Overassessment
				5. Date or Sched. No.	6. Amount		
1947	1948L	9122983					\$2,706.51 Credited to Acct. No. 599134 Schedule #7468 Dated 7/28/48
1947	1950L	8510586	2,825.67				870—5/31/50 272-D
		Int. to 6/30/50	388.42				
				9/15/50	2,082.67	Pd.	
				10/20/50	643.47	Sch. B-515	
					1,558.92	Sch. B-515	
			323.49				Trf. to 8-51058
			3.69				Interest
			743.79				Schedule C-4725
Note: Claim Filed 7/30/52 #17—9/8/50							
1948	1949L	3196022	7,385.83	3/15/49	7,385.83	Pd.	
1948	1950L	8510585	10,933.83				870—5/31/50 272-D
		Int. to 6/30/50	846.93				Hold—Offset on
				9/15/50	8,964.71	Pd.	Form 1331 in P
					643.47	Sch. B-515	
					643.47	Sch. B-515	
				10/20/50	1,558.92	Sch. B-515	
			13.54				Interest
			16.27				Excess Sch. C-47

Note: Claim Filed 6/30/50
#17—9/8/50

I certify that the foregoing transcript of the accounts of the taxpayer named above in respect to the taxes specified, is true and complete for the period stated, and that all assessments and payments of tax, penalty and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office are shown therein.

Date of Certificate: October 24, 1955.

District Director of Internal Revenue R. A. Riddell.

U. S. Treasury Department, Internal Revenue Service Code 1126:NN (1232:NN).

PLAINTIFFS' EXHIBIT No. 64-G

Certificate of Assessments and Payments

Office of District Director of Internal Revenue, Los Angeles, California.

To: Chief Counsel, Washington 25, D. C.

In Re: (Name of Taxpayer) Flo Parker, 1205 So. Burris Ave., Compton, Calif., or Box 629, Compton, California.

Attention: CC:M, September 22, 1955.

The following is a transcript of the records of this office covering the accounts of the taxpayer named above in respect to (character of tax): Income. For the (period covered): Years—1947 and 1948.

2. List and Year	3. Acct. No. Or Page and Line	4. Amount Assessed	Paid. Abated. or Credited		7. Paid AB. CR.	8. Adjustment of Overassessments
			5. Date or Sched. No.	6. Amount		
1948L	9122984					Credit \$2,767.18 Acct. #5991384 Sch. #7468 7/28/48—1947
1950L	8510587	2,811.57				870—5/31/50
	Int.	386.48				272-D
			9/15/50	2,066.43	Pd.	Hold Offset on
			10/20/50	643.47	Sch.	Form 1331 in Process
				1,558.92	Sch.	B-515
		1,070.97				B-515
						Trf. to 11-580391-50L

cc: Claim Filed 6/30/50.

#17—9/8/50.

1947 1950L 11580391 1,070.97 1,070.97 Trf. Fr. 8-510587-50L

Note: \$1,070.97 Trf'd. to Acct. #8510588-50L

Schedule IT:B-638.

1948 1949L 3196023 7,650.23 3/15/49 7,650.23 Pd. 436 E. Dixon St

1948 1950L 8510588 10,669.45

Add'l. Int. to 6/30/50 826.46 9/15/50 8,602.21 Pd.

1,508.66 Abt. Sch. B-557

11/20/50 Post-

2/19/51

1,070.97 Sch. B-638

323.49 Trf. Fr. 8-510586-50L

Int. 9.42

Note: Claim Filed 7/30/52.

#17—9/8/50.

I certify that the foregoing transcript of the accounts of the taxpayer named above in respect to the taxes specified, is true and complete for the period stated, and that all assessments and payments of tax, penalty and interest, and all abatements, credits, and refunds relating thereto as disclosed by the records of this office are shown therein.

Date of Certificate: November 15, 1955.

District Director of Internal Revenue R. A. Riddell.

U. S. Treasury Department, Internal Revenue Service Code 1126.NN (1232:ids).

DEFENDANTS' EXHIBIT A

[Title of Superior Court and Cause.]

MEMORANDUM IN RE INCIDENCE OF FEDERAL INCOME TAX LIABILITY ON 1944 PARTNERSHIP INCOME

A. Result If Children Pay No Tax At All.

	Share of Partnership Income	Tax Burden	Balance left After Federal Tax
Father	\$69,138.48	\$ 97,053.85	(\$27,915.37)
Mother	69,138.48	96,838.84	(27,700.36)
Flo Dian	31,569.24	-----	31,569.24
Patricia	31,569.24	-----	31,569.24
Rowland	31,569.24	-----	31,569.24
Arthur	31,569.24	-----	31,569.24
Totals	<u>\$264,553.92</u>	<u>\$193,892.69</u>	<u>\$70,661.23</u>

B. Result If All Share The Tax Burden In The Original Proportions

	Share of Partnership Income	Tax Burden	Balance left After Federal Tax
Father	\$ 69,138.48	\$ 57,973.91	\$11,164.57
Mother	69,138.48	57,702.46	11,436.02
Flo Dian	31,569.24	19,554.08	12,015.16
Patricia	31,569.24	19,554.08	12,015.16
Rowland	31,569.24	19,554.08	12,015.16
Arthur	31,569.24	19,554.08	12,015.16
Totals	<u>\$264,553.92</u>	<u>\$193,892.69</u>	<u>\$70,661.23</u>

C. Result If Children Pay All of The Additional Tax

	Share of Partnership Income	Tax Burden	Balance left After Federal Tax
Father	\$ 69,138.48	\$ 41,464.15	\$27,674.33
Mother	69,138.48	41,276.65	27,861.83
Flo Dian	31,569.24	27,787.98	3,781.26
Patricia	31,569.24	27,787.97	3,781.26
Rowland	31,569.24	27,787.97	3,781.26
Arthur	31,569.24	27,787.97	3,781.26
Totals	<u>\$264,553.92</u>	<u>\$193,892.69</u>	<u>\$70,661.20</u>

Comments

1. Situation A is insufferable and unintended.

2. Situation B is unsatisfactory because the parents pay California Income Tax of about \$3000.00 each, in addition to the Federal tax, and support themselves and five children. This would take approximately all of their earnings, while the four children grew rich. This would be unfair to the fifth child, which has received no gift.

The parents paid considerable gift taxes on the 1943 gifts of interests in the business. Furthermore, the tax authorities will probably contend that the parents are subject to gift tax on the profits of each year which are credited to the children—that this was the parents' income, and when set over to the children on the partnership books, constitute a taxable gift.

The father received a salary of but \$12,000, whereas his services were worth at least \$52,000 per year. If a full and fair salary of \$52,000 per year

had been paid the father, a result more comparable to that shown in situation C would have obtained.

3. Situation C is most equitable result. Out of the balance remaining to the parents, they would pay California income tax of about \$3,000 a year each, support themselves and five children, and have a reasonable balance left. The children would build up a considerable amount over a period of years.

The parents furnished all of the capital, do all the work and support the children, so should be taken care of first.

Under C, the children would still be in a favorable and fortunate position. They would receive, after all taxes, State and Federal, about 12% on their original gift.

4. California income tax is still to be reckoned with, and should be settled on the same basis as the Federal tax.

5. This problem continues for all of 1945 and for four months of 1946, after which corporations were formed.

/s/ MELVIN D. WILSON

E. R. Parker

Computation Supporting Schedule B.

1. Taxpayer	2. Federal Tax Paid on Return	3. % of Total Tax Origin- ally Paid	4. Correct Tax Liability per R.A.R. Allocated as in Column 3	5. Additional Tax to be Borne (5-2)
E. R. Parker	\$ 41,464.15	\$29,900	\$57,973.91	\$16,509.76
Flo Parker	41,276.65	29,760	57,702.46	16,425.81
Flo Dian Parker	13,986.09	10,085	19,554.08	5,567.99
Patricia Lee Parker	13,986.09	10,085	19,554.08	5,567.99
Rowland Tibbetts Parker	13,986.09	10,085	19,554.08	5,567.99
Arthur Elgin Parker	13,986.09	10,085	19,554.08	5,567.99
Totals	138,685.16	100,000	193,892.69	55,207.43

Taxes to Be Borne By Minors

	Tax Already Paid	Additional Tax	Total Tax
Flo Dian Parker	\$13,986.09	\$ 5,567.99	\$19,554.08
Patricia Lee Parker	13,986.09	5,567.99	19,554.08
Rowland Tibbetts Parker	13,986.09	5,567.99	19,554.08
Arthur Elgin Parker	13,986.09	5,567.99	19,554.08
	\$55,944.36	\$22,271.96	\$78,216.32
By E. R. Parker		16,509.76	
By Flo Parker		16,425.81	
Total Additional Tax		\$55,267.63	

MELVIN D. WILSON

D. Result If Tax Burden Is Shared In Proportion
to Income Distribution

	Share of Partnership Income	Tax Burden	Balance left After Federal Tax
Father	\$ 69,138.48	\$ 48,473.17	\$20,665.31
Mother	69,138.48	48,473.17	20,665.31
Flo Dian	31,569.24	24,236.59	7,332.65
Patricia	31,569.24	24,236.59	7,332.65
Rowland	31,569.24	24,236.59	7,332.65
Arthur	31,569.24	24,236.58	7,332.66
Totals	<u>\$264,553.92</u>	<u>\$193,892.69</u>	<u>\$70,661.23</u>

Comment on D

The above balances are before California Income Taxes of about \$3,000 for each parent, and about \$800 for each child. The parents receive from the partnership, in addition to 50% of the profits, salaries of \$12,000, out of which they support the family. The tax on this salary is treated as being shared by all the partners in proportion to their shares of the partnership income remaining after paying the salary.

This method of tax bearing is most simple and would be satisfactory.

[Note: Certificates of Assessments and Payments are set out at pages 28-29.]

[Title of District Court and Causes Nos. 13392,
13391, 18772, 18773.]

REPORTER'S TRANSCRIPT

* * * * *

The Court: The matter will stand submitted, gentlemen. I want to go over the documentary evidence a little more carefully than I have had occasion to do.

Each of these cases has its own peculiarities, which have to be considered. There are many elements which have developed on the trial which did not exist in some of the other cases. Perhaps one of the most significant is that [247] there is no general power, such as existed in some of the others, of the managing partner to terminate the partnership or of making disposition of the profits except in accordance with the general partnership agreement.

There is a provision for dissolution at the request of any of the partners, but that is one of the grounds contained in the law of California, which has adopted a uniform partnership law. And there is also a provision to which I have alluded before, that other than on dissolution equal rights existed as to the other partners when it came to transferring interest, that is, a provision is made whereby upon any sale an opportunity be given to the others to purchase within a period, as I remember, of 90 days, and other than borrowing money for tax purposes, there is no power in the partnership or the managing partner to treat the minors in any other

manner than he himself and his wife would be treated. So that, although the managing partner exercised the general control of any general partner, there is a provision that additional salaries and bonuses may be voted, and it provides that it shall be done at the vote of the partners.

There is no showing that that was ever done, but, on the contrary, the \$12,000 salary continued until the partnership assets had been converted into stock, and with the rise of the corporation, the guardian merely became [248] a representative of the particular stockholders.

It is also a fact that so far as the transfer of the particular interests is concerned, it not only was irrevocable, but it has remained such, and that in one form or another the interest of the minors has continued through the minority, and as to the two children who are minors at the present it still continues.

I think the hope or aspiration of the children remaining in the business is rather illusory in this case, because of the fact that the two older children are women, who have since married, and who were minors at the time the partnership ceased to exist. And the boys were too young, and even as of today are not certain they will go in, so the element of possible contribution of services is almost nil.

That is, of course, only one of the matters to be considered. Ultimately I have to determine whether a business purpose was achieved in the creation of the corporation. If the business purpose was achieved, then the fact that incidentally a tax bene-

fit was derived would not destroy the original business purpose. Neither would the contrary result. The existence of a business advantage is to be considered not in the light of what happened afterwards, but in the light of what situation presented itself at the time.

During the course of the short trial, I have intimated [249] by questions that in view of the fact that Mr. Parker had not been successful in business prior thereto, there was an element of risk involved in the business, and that the creation of the partnership was no protection to the children.

I think possibly it is rather unfair to place before a lay person, who thinks he is achieving security for his children, the fact of choosing a vehicle that would not achieve that result. In other words, by creating a general partnership, he did not create any special security for the children, except in the event the general partnership was successful. If it had been a special partnership, the failure of the partnership would carry only the risk of the capital investment of each of the members of the limited partnership.

I think since the early cases in this field the courts have changed their attitude. Instead of looking askance at the desire of parents to endow their children, as it were, they look at them with favor. The entire psychology has changed in that respect. The large number of young men who were allowed to marry while they were in Service, knowing full well that when they came out they would have to continue their education, and that one or

the other of the family would have to support them, is evidence of that. And the very fact that the girls in this case married young men, who possibly expected to go through college under the G.I. [250] Bill, or the assistance of their families or their wives, indicates a change in the social attitude, which is also reflected in the courts' attitude towards matters of this character.

It used to be the pioneer attitude in the American family that the children ought to start where we started, and to have to go through the same rigors as we did. Those of us who were in the first World War do not remember any generosity with which the Government treated either the soldiers or their dependants. There was then no provision such as we have now in the wholesale provision for continuing school, and that right was never given us. As it is, at the last count, it was determined, I think, that there are over a million professional men who probably could not have qualified or would not have been able to finish their education but for this governmental assistance.

I am merely referring to the fact that I can see in the decisions of the courts a reflection of a change of attitude in the entire social thinking, whereby the idea of children acquiring and being given an interest in the family business, which may ultimately result in what the continent of Europe has as an inheritance from Roman law, and that is the vested right of a child in the estate of his parents, of which he cannot be deprived except for good reason. [251]

I am just expressing some stray thoughts on one side or the other, to indicate to you some of the matters which have to be considered in this particular case. There are many elements present in some of the other cases, some of which I myself have decided, which simply are not present here. One of the most significant ones is that except through failure the father had no way of milking the business, as it were, or even of exacting unreasonable compensation for his services, or forcing a sale. All the conditions were equal. Whatever right he had, the others had.

It is true that in a sense he dealt with himself, but even a probate court, exercising its supervisory duties in the most cursory manner, could not have allowed, under the wording of the partnership agreement following the gift, any of the exploitation of the estate of the type which was present in some of the other cases.

That is why I feel this case requires a little more detailed study in its various ramifications than I have been able to give to it during the course of the trial.

So the matter will stand submitted. [252]

* * * * *

[Endorsed]: Filed Aug. 17, 1956.

[Title of District Court and Causes Nos. 13392,
13391, 18772, 18773.]

STATEMENT OF POINTS TO BE RELIED UPON

Now come the plaintiffs to the above-entitled cases and file the following statement of points to be relied upon in the appeal of the above-entitled cases and from the final judgment made by this Honorable Court on the 12th day of July, 1956.

I.

The District Court erred in adopting the findings of fact and conclusions of law filed by the defendants.

II.

The Court erred in failing to find that there were legitimate business purposes for the plaintiffs giving interests in the assets and business of Southern Heater Company to their four children and making them partners.

III.

The Court erred in failing to find that the primary purposes of making such gifts and making the children partners was to help the children and give them security and to constitute an inducement to their furnishing successor management to the business.

IV.

The Court erred in failing to find that the legitimate business reasons for making the gifts to the children and making them partners have in large part been fulfilled.

V.

The Court erred in failing to find that the plaintiffs [223] turned over the control of their business to the Probate Court administrating the guardianship estates of the children.

VI.

The Court erred in failing to find that the plaintiffs changed their economic status by giving fifty per cent of their interests in the business to their children.

VII.

The Court erred in failing to find that the gifts to the children were irrevocable, complete and unconditional.

VIII.

The Court erred in failing to find that the children's interest in the partnership were fully protected by their guardian, supervised by the Probate Court, and that the children thus had absolute control over their properties, including their interests in the partnership.

IX.

The Court erred in failing to find that the children really and truly owned interests in the business and in the partnership and should be taxed on the income therefrom.

X.

The Court erred in failing to find that the plaintiffs really and truly intended to make outright gifts of interests in the business to the children and

to make the children partners with them in the conduct of said business.

XI.

The Court erred in failing to find that the capital owned by the children and used in the business was necessary and useful to the business.

XII.

The Court erred in failing to find that capital was a material income producing factor in the business of Southern Heater Company and that the children owned interests in such [224] capital.

XIII.

The Court erred in failing to find that if the children really and truly owned their interests in the business, and had control over their assets and income therefrom, it is immaterial that taxes may be saved by the old partners through the admission of the new partners.

XIV.

The Court erred in failing to find that it is immaterial that the old partners held the interests of the new partners in a fiduciary capacity.

XV.

The Court erred in failing to find that it was immaterial that one of the old partners ran the business as a general partner and as a fiduciary under the supervision of the Probate Court.

XVI.

The Court erred in failing to find that it was

immaterial that the earnings of the partnership were not completely distributed to the new partners since the new partners had the right to the distribution of their income.

XVII.

The Court erred in failing to find that the children's retained earnings, used in the business, constituted capital originating with the children.

XVIII.

The Court erred in failing to find that the salaries paid to Elgin R. Parker by the partnership were fair, adequate and reasonable.

XIX.

The Court erred in failing to find that the children's shares of the income were not used for the benefit of the [225] plaintiffs.

XX.

The Court erred in failing to find that after April 30, 1946, the partnership was passive, merely owning stocks, notes and real estate leased on a long-term basis.

XXI.

The Court erred in failing to find that the children were partners in the business of Southern Heater Company and they only should be taxed on their shares of the partnership income.

XXII.

The judgment against the appellants should be reversed.

Dated: August 24, 1956.

MUSICK, PEELER & GARRETT

MELVIN D. WILSON

JOHN P. POLLOCK

/s/ MELVIN D. WILSON

Attorneys for Plaintiffs

Acknowledgment of Service Attached.

[Endorsed]: Filed Aug. 29, 1956.

[Title of District Court and Causes Nos. 13391,
13392, 18772, 18773.]

CERTIFICATE BY CLERK

I, John A. Childress, Clerk of the above-entitled Court, hereby certify that the items listed below constitute the transcript of record on appeal to the United States Court of Appeals for the Ninth Circuit, in the above-entitled cause;

A. The foregoing pages numbered 1 to 236, inclusive, containing the original

Complaint (13391-Y);

Answer (13391-Y);

Amended Complaint (13391-Y);

Stipulation for Consolidation (13391-Y & 13392-Y);

Complaint (18772-Y);

Complaint (18773-Y);

Answer (18772-Y);

Answer (18773-Y);

Answer to Amended Complaint (13391-Y);

Answer to Amended Complaint (13392-Y);

Decision (13391-Y);

Decision (13392-Y);

Objections to Form and Content of Proposed Findings of Fact & Conclusions of Law;

Findings of Fact, Conclusions of Law and Judgment;

Notice of Appeal (13392-Y & 13391-Y);

Notice of Appeal (18772-Y & 18773-Y);

Certificate of Service by Mail of Notice of Appeal (13391-Y & 13392-Y);

Certificate of Service by Mail of Notice of Appeal (18772-Y & 18773-Y);

Statement of Evidence; Condensation of oral testimony given at the Trial;

Statement of Points Relied On;

Designation of Contents of Record on Appeal;

Stipulation & Order for Extension of Time to Docket Cause on Appeal and to Extend Time of the Appellees to Counter-Designate Record;

Stipulation & Order Extending Time of Appellees to Counter-Designate Record on Appeal;

and a full, true and correct copy of

Complaint (13392-Y);

Answer (13392-Y);

Amended Complaint (13392-Y);

B. 1 volume of reporter's Official Transcript of Proceedings had on May 1, 2, 3, 1956;

C. Plaintiffs' exhibits 1 - 64-G, inclusive and defendant's exhibit A.

I further certify that my fee for preparing the

foregoing record, amounting to \$2.00, has been paid by appellant.

Witness my hand and the seal of the said District Court, this 24th day of October, 1956.

[Seal] JOHN A. CHILDRESS,
 Clerk
/s/ By CHARLES E. JONES,
 Deputy

[Endorsed]: No. 15340. United States Court of Appeals for the Ninth Circuit. Elgin R. Parker and Flo Parker, Appellants, vs. Harry C. Westover, individually and as Former Collector of Internal Revenue for the Sixth District of California, Appellee. Elgin R. Parker and Flo Parker, Appellants, vs. R. A. Riddell, District Director of Internal Revenue, Los Angeles, California, Appellee. Transcript of Record. Appeals from the United States District Court for the Southern District of California, Central Division.

Filed: October 25, 1956.

/s/ PAUL P. O'BRIEN

Clerk of the United States Court of Appeals for the Ninth Circuit.

In the United States Court of Appeals
For the Ninth Circuit

No. 15340

No. 13,392-Y—Civil. Elgin R. Parker, Plaintiff,
vs. Harry C. Westover, Individually and as Former
Collector of Internal Revenue for the Sixth District
of California, Defendant.

No. 13,391-Y—Civil. Flo Parker, Plaintiff, vs.
Harry C. Westover, Individually and as Former
Collector of Internal Revenue for the Sixth Dis-
trict of California, Defendant.

No. 18,772-Y—Civil. Elgin R. Parker, Plaintiff,
vs. R. A. Riddell, District Director of Internal
Revenue, Los Angeles, California, Defendant.

No. 18,773-Y—Civil. Flo Parker, Plaintiff, vs.
R. A. Riddell, District Director of Internal Reve-
nue, Los Angeles, California, Defendant.

STIPULATION FOR CONSOLIDATION OF
RECORD ON APPEAL

It is hereby stipulated by and between the parties
hereto, through their respective counsel, that the
records on appeal in the above entitled cases may be
consolidated, so that only one record need be printed
and it shall apply to all cases equally.

Dated this 22nd day of August, 1956.

MUSICK, PEELER & GARRETT

MELVIN D. WILSON

JOHN P. POLLOCK

/s/ By MELVIN D. WILSON

Counsel for Plaintiffs

/s/ By CHARLES K. RICE

Assistant Attorney General

Counsel for Defendants

So Ordered:

/s/ WILLIAM DENMAN

Chief Judge

/s/ HOMER T. BONE

/s/ FREDERICK G. HAMLEY

United States Circuit Judges

[Endorsed]: Filed Sept. 6, 1956. Paul P.
O'Brien, Clerk.

[Title of Court of Appeals and Causes.]

STATEMENT OF THE POINTS ON WHICH
APPELLANTS INTEND TO RELY

To the United States Court of Appeals for the
Ninth Circuit:

Appellants hereby adopt the Statement of the
Points on which they intend to rely, which was
filed in the District Court, as their statement of the
points on which they intend to rely in this Court.

Dated: August 27, 1956.

/s/ MELVIN D. WILSON

Counsel for Appellant

[Endorsed]: Filed Sept. 28, 1956. Paul P.
O'Brien, Clerk.

[Title of Court of Appeals and Causes.]

DESIGNATION OF RECORD TO BE PRINTED

United States Circuit Court of Appeals for the
Ninth Circuit:

The appellants hereby designate the following
parts of the record, which they desire to have
printed, as necessary for the consideration of the
appeal:

1. The Amended Complaint, filed by Elgin R.
Parker, for the years 1945 and 1946.

2. The Answer to the Amended Complaint filed
by Elgin R. Parker, for the years 1945 and 1946, or
if no Answer was filed, the Answer to the original

Complaint filed by Elgin R. Parker, for the years 1945 and 1946.

3. Stipulation for Consolidation of Cases for Trial.

4. Statement of the Evidence, together with exhibits or parts of exhibits specified in said Statement of the Evidence to be printed in full.

5. Findings of Fact and Conclusions of Law.

6. Objections to Form and Content of Proposed Findings of Fact and Conclusions of Law.

7. Judgments.

8. The portion of the reporter's transcript of the proceedings, beginning on line 19 of page 247 and continuing to line 20 of page 252, inclusive.

9. Notices by Clerk of Entry of Judgments.

10. Notices of Appeal with the Filing Dates.

11. Stipulation as to Consolidation of Record on Appeal.

12. Designation of matters to be included in the record (District Court).

13. Designation of matters to be included in the printed record (Circuit Court).

14. Designation of points on which appellants intend to rely (District Court).

15. Designation of points on which appellants intend to rely (Circuit Court).

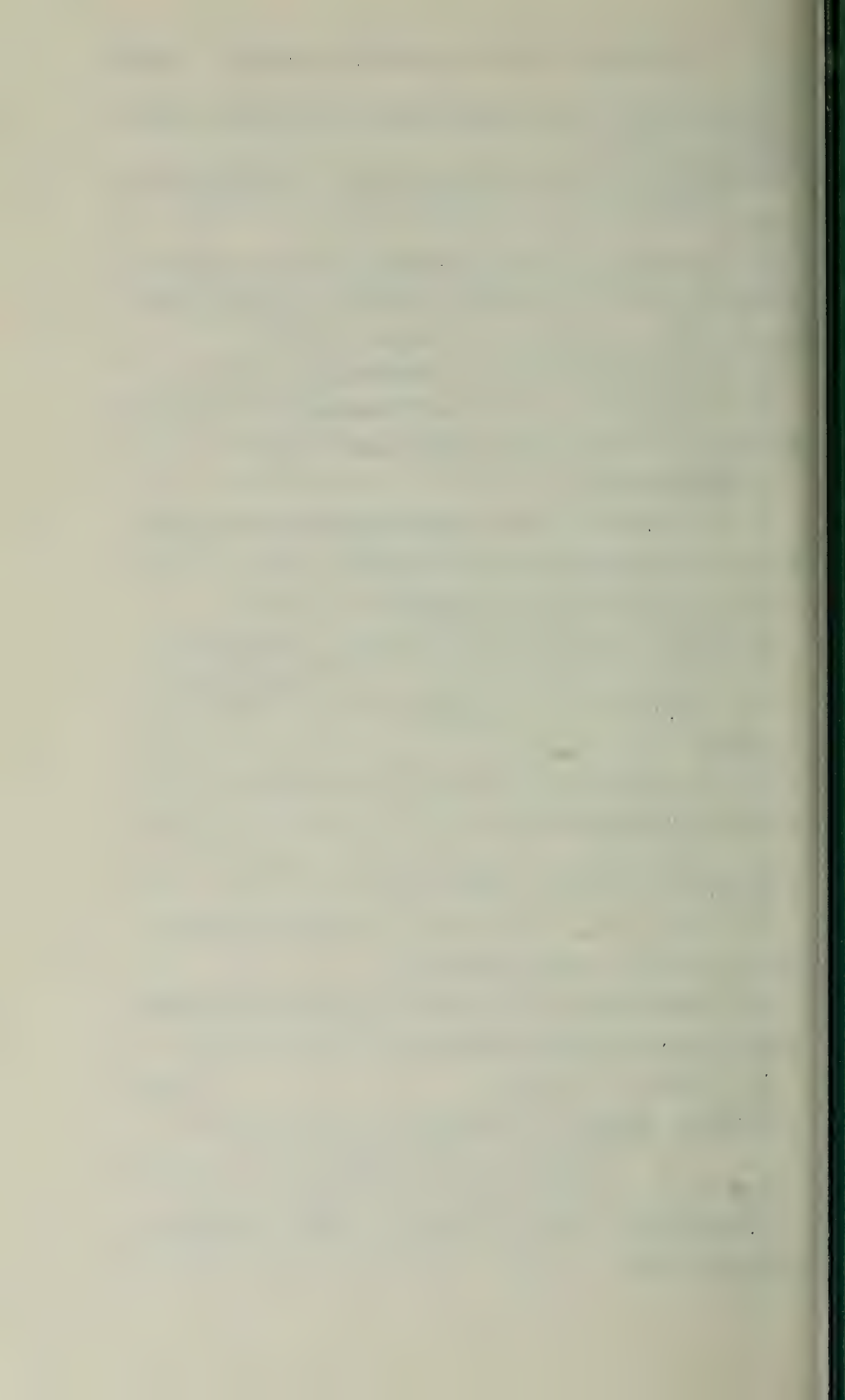
16. Clerk's Certificate.

Dated: August 27, 1956.

/s/ MELVIN D. WILSON

Attorney for Appellant

[Endorsed]: Filed Sept. 28, 1956. Paul P. O'Brien, Clerk.



No. 15340

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELGIN R. PARKER,

Appellant,

vs.

HARRY C. WESTOVER, Individually and as former Collector of Internal Revenue for the Sixth District of California,

Appellee.

FLO PARKER,

Appellant,

vs.

HARRY C. WESTOVER, Individually and as former Collector of Internal Revenue for the Sixth District of California,

Appellee.

ELGIN R. PARKER,

Appellant,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles, California,

Appellee.

FLO PARKER,

Appellant,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles, California,

Appellee.

Appeal From the United States District Court for the Southern District of California, Central Division.

BRIEF FOR THE APPELLANTS.

MELVIN D. WILSON,

621 South Hope Street,

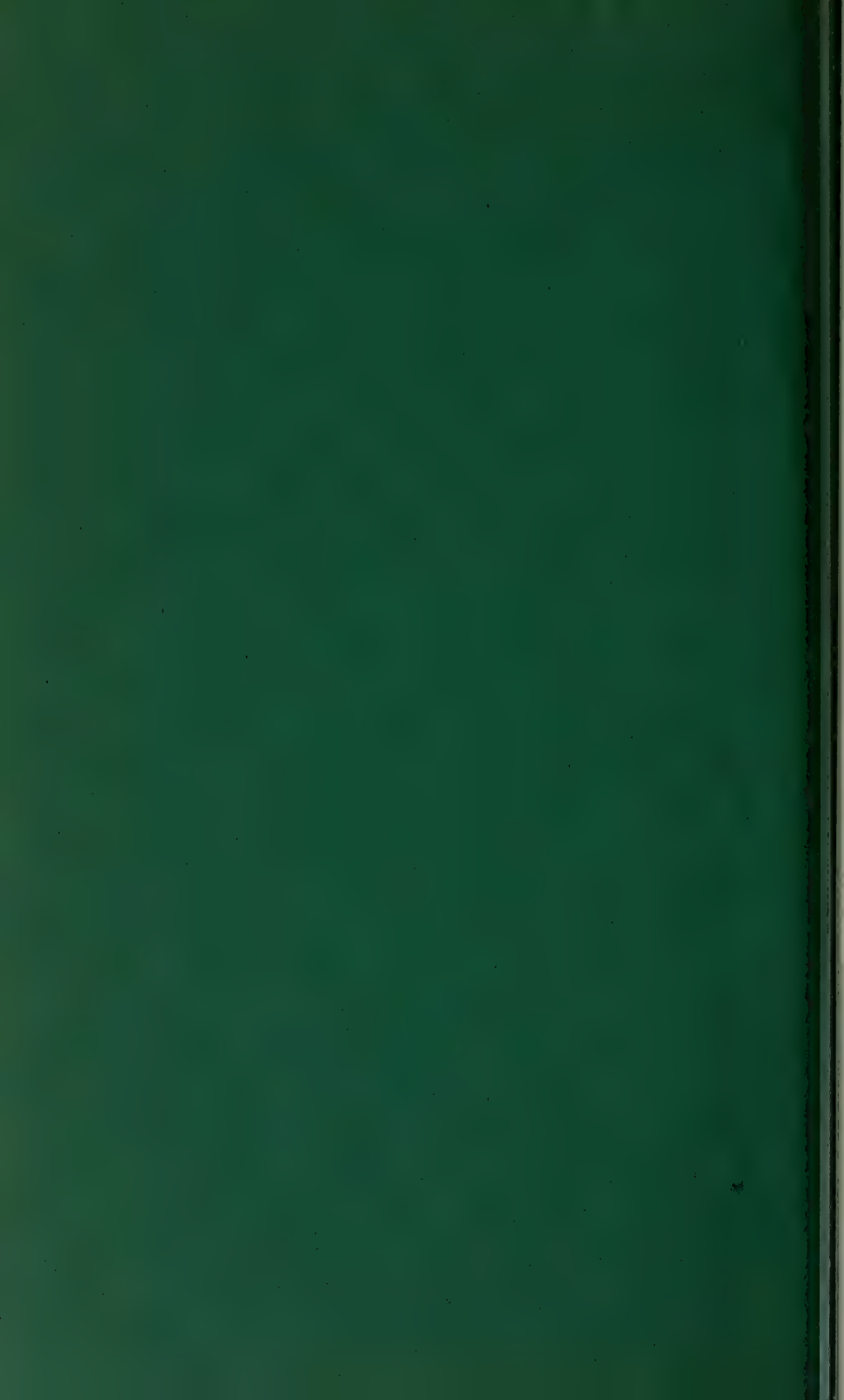
Los Angeles 17, California,

Attorney for Appellants.

FILED

APR - 5 1957

PAUL P. O'BRIEN, CLERK



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No. 15340
IN THE
United States Court of Appeals
FOR THE NINTH CIRCUIT

ELGIN R. PARKER,

Appellant,

vs.

HARRY C. WESTOVER, Individually and as former Collector of Internal
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Appellant,

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ELGIN R. PARKER,

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R. A. RIDDELL, District Director of Internal Revenue, Los Angeles,
California,

Appellee.

FLO PARKER,

Appellant,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles,
California,

Appellee.

**Appeal From the United States District Court for the
Southern District of California, Central Division.**

BRIEF FOR THE APPELLANTS.

Opinion Below.

The opinion of the United States District Court for the Southern District of California, Central Division, is reported at 144 Federal Supplement 933, and is found in the Record at page 31.

Jurisdiction.

These appeals involve federal income taxes. The taxes in dispute were paid by the appellants, Elgin R. Parker and Flo Parker. The taxes for 1945 and 1946 were paid to the Collector of Internal Revenue for the Sixth District of California and for 1947 and 1948, to the District Director of Internal Revenue for Los Angeles, California.

The proceeding involves gross claims for refunds as follows:

<u>Year</u>	<u>Elgin R. Parker</u>	<u>Flo Parker</u>
1945	\$55,682.54	\$56,177.58
1946	\$69,631.37	\$69,631.38
1947	\$ 2,825.67	\$ 2,811.57
1948	\$10,933.83	\$10,669.45

[R. 5, 13, 20, 24.]

The *net* amounts involved are the amounts of the claims for refund, less the amounts that will be re-collected from appellants' four children as their income taxes for the same years, if the children are held to be partners for income tax purposes. [R. 53, pars. XIII, XIV.]

Federal Income Tax returns for each year were timely filed by the appellants and the taxes shown to be due thereon were paid. Subsequently the Commissioner of Internal Revenue proposed additional taxes for each of said years. The appellants paid the said proposed additional taxes and filed timely and proper claims for refund therefor. Said claims were rejected by the Commissioner of Internal Revenue and these suits followed. [R. 5, 6, 13, 20, 24.]

The judgments were entered July 12, 1956 and the notices of appeal were filed on August 13, 1956. [R. 57.]

Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340. Jurisdiction is conferred on this Court by 28 U. S. C., Section 1291.

Question Presented.

Where appellants gave to their four children half of the assets in a business, and the Superior Court appointed a guardian and authorized him to enter into a general partnership agreement with appellants for the carrying on of that business, and capital was material in the operations of that business and provided all the income remaining after an adequate salary had been paid to appellant Elgin R. Parker, and the children, through the guardian and Superior Court, controlled their interests and enjoyed their income and assets, did the District Court correctly ignore the children as partners and tax appellants on the children's incomes?

Statutes Involved.

The statutes involved in this proceeding are set out in the Appendix.

Statement of the Case.

Facts Relating to Motive.

This partnership arose out of a bitter experience had by appellants in 1936. Prior to 1930, they had a water heater manufacturing business which had always made profits for them. [R. 58, 59, 86.] From 1930 to 1937, Mr. Parker worked as an executive for another water heater manufacturer. [R. 59.] In 1936 they were thrown into bankruptcy by large real estate debts and obligations which became due in and after the depression when real estate values had dwindled to but a small per-

centage of their original prices. [R. 59.] The real estate operations had been a side line with appellants. [R. 59.]

After being discharged from bankruptcy, Elgin R. Parker continued to work for other water heater manufacturers for a time [R. 59], and then by virtue of savings and a gift from a relative, he again bought the Southern Heater Company, partly on credit [R. 86], and by 1943 had built up a profitable business. [R. 59, 71.]

Mr. and Mrs. Parker were determined to give some security to their children as soon as possible so that the children would have some means of support should the parents again get into straitened financial circumstances. [R. 60.]

In addition to desiring to give the children some security, the appellants hoped that eventually the children would grow up and remain in the business and provide successor management for it. [R. 61.]

On October 31, 1943, each appellant owned as his or her separate property a one-half interest in a partnership known as Southern Heater Company. [R. 59.] Elgin R. Parker managed the business from which he took a salary of \$12,000 a year. [R. 64.]

This business was the only asset of any consequence appellants had at that time. It was making substantial profits and, although the war made it difficult to obtain materials, there was a reasonable expectation that the business would continue to be profitable. [R. 68, 69, 71, 86.] In fact, the Commissioner of Internal Revenue determined that the business had a valuable good will, and imposed gift taxes on the October 31, 1943 gift of the good will hereinafter described. [R. 7, par. XII, R. 21, par. XII.]

As of October 31, 1943, each appellant gave to each of his or her four children a six and one-quarter per cent interest in the business. The gifts were represented by deeds which were absolute and unconditional and did not depend in any way on whether the children left their shares of the assets in the business, whether the children entered into a partnership with the donors, or whether the assets given them were sold and the proceeds invested in securities. [R. 94, 117; Pltf. Exs. 1 and 2.]

After making the gifts, Elgin R. Parker applied to the Superior Court of Orange County, in which County the family was then living, for appointment of himself as guardian of the persons and estates of the children so that they would have someone to look after their assets, under the supervision of the court. [R. 96, Pltf. Ex. 11.] The court appointed Mr. Parker as guardian provided he file four corporate surety bonds of \$23,000 each which was approximately the cost of the assets given to each child. Eventually the bonds were written and filed, whereupon Elgin R. Parker was appointed guardian. [R. 96, Pltf. Ex. 12.]

Articles of Co-partnership were prepared and presented to the court and approved and signed by the appellants for themselves individually and by Elgin R. Parker as guardian for the four children. [R. 121, Pltf. Ex. 3.] The partnership took effect as of November 1, 1943. [R. 94, par. 3.] The children contributed their assets to the capital of the partnership, for an interest of 50% in the capital and income of the partnership. [R. 122, Pltf. Ex. 3.] They provided for a general partnership and authorized a salary of \$12,000 per year for Elgin R. Parker, subject to adjustment by written agreement of the partners. [R. 125, par. 10.] This was a reasonable salary.

[R. 64, 69, 70, 81, 82, 168, Pltf. Ex. 63.] The Commissioner of Internal Revenue used a salary of \$12,000 in determining the value of the good will for gift tax purposes. [R. 7, par. XII, R. 21, par. XII.]

The partnership was organized to engage in the heater manufacturing business only, and not to engage in real estate transactions. [R. 121, par. 2.]

Under the California law, each partner had an equal voice in the management of the business and hence the Superior Court through the guardianships had four votes, as opposed to two for the appellants. (Cal. Corp. Code, Sec. 15018(e).)

Since November 1, 1943, the guardian has filed annual accounts with the court and has had such accounts approved and has operated and managed the guardianship investments and estates and the partnership under the supervision and jurisdiction and under the orders of the Probate Court. [R. 97-116, incl., Pltf. Exs. 3-59, incl.]

The partnership filed certificates of fictitious firm name [R. 95, Pltf. Ex. 6], and was otherwise created with all the necessary legal formalities and was held out as a partnership in all dealings with the tax authorities, the surety company, the Probate Court and the creditors. [R. 94-95, Pltf. Exs. 4-6.]

The appellant's objectives in making the gifts and creating the partnership have been in large part fulfilled. Each child has assets costing over \$122,000 and each receives dividends from his or her stock averaging around \$7,000 per year. [R. 113-115, Pltf. Exs. 56, 57.] The two

boys are still in school and are taking courses in Commerce and Engineering, respectively, which training would be helpful in the business. Though they are as yet undecided as to what they wish to do when they have completed their education, it seems quite reasonable to expect that one or both of them will enter the business as his lifetime career. [R. 63, 73, 89, 90, 91.]

Facts Relating to Business Purpose.

At the time of the gifts, the assets in the former partnership consisted of land and building, machinery, inventory, accounts receivable and cash. These aggregated around \$311,000. [R. 163, 164, Pltf. Ex. 58.] All were absolutely necessary in the conduct of this business. [R. 60, 69, 71, 79.]

After the gifts, each parent owned a 25% interest in these assets and the children collectively owned a 50% interest therein. The current assets as of the date of the gift were about twice the current liabilities [R. 163, 164, Pltf. Ex. 58], which is a normal ratio for a manufacturing business. It was necessary to have cash on hand in order to buy steel when it became available and necessary to have considerable working capital to carry the accounts receivable, payrolls, taxes and other operating expenses. [R. 69.]

In order for the business to grow, it was necessary to retain in it most of the earnings, since Elgin R. Parker had a policy against borrowing money. [R. 69, 79.] The children's initial capital interests in the partnership aggregated about \$99,000. [R. 165, Pltf. Ex. 60.] As a

result of their earnings and the retention of earnings in the business, their investments in the firm were as follows:

October 31, 1943	\$ 98,983.92
October 31, 1944	\$165,541.68
October 31, 1945	\$217,671.76
October 31, 1946	\$357,168.76
October 31, 1947	\$302,371.00
October 31, 1948	\$338,359.68

[R. 165, Pltf. Ex. 60.]

While the \$99,000 initially contributed by the children came from gifts, the increases were the children's contributions of original capital. (*Parker v. Westover*, 221 F. 2d 603, 606.)

Capital was a material income-producing factor in the business. It produced all of the profits of the business after adequate salaries had been paid to the employees and Elgin R. Parker. [R. 60, 64, 69, 71, 79.]

As of May 1, 1946, the land and building were retained in the partnership but all of the other assets used in the heater business were transferred to two corporations in exchange for the stocks of those corporations. One company, the Southern Heater Corporation, took over the business of manufacturing water heaters, and the other company, the American Control Company, took over the business of manufacturing control equipment. [R. 98, 99, Pltf. Exs. 23, 25.] Thereafter the partnership reduced the salary of Elgin R. Parker to \$200 instead of \$1,000 per month [R. 95, Pltf. Ex. 8, R. 64], and henceforth the land and building were leased to Southern Heater Corporation for \$30,000 per year, plus taxes, insurance and repairs. [R. 99, Pltf. Ex. 23.] In

September, 1948, the land and building were transferred into a third corporation, Parker Realty Company, in exchange for all its stock. [R. 100, 101, Pltf. Exs. 32, 34.]

From May 1, 1946, until the partnership was dissolved on October 31, 1948, the partnership was merely passive, owning stocks and until September, 1948, holding property under a long term lease. It paid an adequate salary to Elgin R. Parker for his nominal management duties and the remainder of the income from the partnership was obviously due to its capital. [R. 64.]

All of the income allocated to the minor partners was from their capital invested in the business.

**Facts Relating to Reality of Ownership
by the Children.**

The gifts of interests in the business as of October 31, 1943, were irrevocable and unconditional. [R. 94, Pltf. Exs. 1 and 2.] The parents had no control over the children's property, as only a court-appointed guardian could control it. (Cal. Civ. Code, Sec. 202.)

Elgin R. Parker was appointed guardian [R. 96, 97, Pltf. Exs. 12, 15], and asked the court to allow the children's interests to remain in the business and to allow him, as guardian, to become a partner in the business. [R. 97, Pltf. Exs. 13, 14, 16, 17.]

The court could have refused these applications and required the children to sell their assets and invest them in government bonds or other low-yielding securities. Instead, the court approved the requests and authorized the guardian to enter into the partnership and to leave the assets in the business and to retain earnings in the business for future growth. [R. 97, Pltf. Exs. 13, 14.]

The partnership was a general partnership and each partner had authority to bind the business. [R. 97, Pltf. Exs. 16, 17.]

The partnership agreement provided that any partner could dissolve it at any time [R. 122, Pltf. Ex. 3, par. 4], or sell his interest at any time provided he gave the other partners the right for a limited period to acquire that interest for the offered price, upon the failure of which he could sell it to anyone. [R. 126, 127, Pltf. Ex. 3, par. 13.]

Distributions of income and payment of compensation to Mr. Parker were to be fixed by the vote of the partners. [R. 124, 125, Pltf. Ex. 3, pars. 8, 10.] The appellants did not have any rights that the other partners did not enjoy and there was no possibility for the appellants to take advantage of the children in any manner whatsoever. Elgin R. Parker, as a general partner, managed the business. He did this in a double fiduciary capacity—first as a general partner, and second as a guardian under the supervision of the court. He filed guardianship bonds and will be liable to the children upon their becoming of age in the event of wrongdoing. [R. 116, Pltf. Ex. 59.]

Books of account were opened by the partnership and the children's capital interests were set up therein and their shares of profit were credited to their accounts. [R. 88,]

When the partnership was dissolved as of October 31, 1948, each guardianship received its share of stocks of the three companies which held the land and building, the heater manufacturing business and the controls business, so that all of the earnings of the partnership were dis-

tributed at that time to the guardianships and the other partners. [R. 130, Pltf. Ex. 10.]

After the business was incorporated, the guardianships have received dividends from the stocks held by them. [R. 105, 106, 109, 113, 114.] The two older children, Flo Diane and Patricia, became of age in 1950 and 1953, respectively, and their guardianships were terminated and they received their shares of the assets free and clear of control by their parents. Each is married and has children. [R. 104, Pltf. Ex. 43, R. 109, 110, 66.]

The guardianships for the two minor sons are still under control of the court [R. 65], and when the boys become of age they will receive their share of assets free and clear of any control by the parents.

The parents continued to support the children as long as they were minors and did not use any of the children's funds for that purpose. [R. 68.] The appellants' economic status was reduced in half by the gifts to the children.

The partnership filed income tax returns, reporting income and showing the six partners and their distributive shares. [R. 70.] The children filed income tax returns, reporting their shares of the partnership income and paid taxes thereon. [R. 70.]

The children, through the guardian and under the supervision of the Probate Court, really and truly owned and controlled their property and their income and their interests in the partnership business.

The appellants filed gift tax returns as a result of the 1943 gifts and paid gift taxes thereon. [R. 63.] The Commissioner of Internal Revenue audited the returns and found that the gifts were irrevocable and complete.

and determined that the business had a valuable good will and increased the gift taxes due to the gift to the children of interests in the good will. Appellants paid the additional gift taxes and no refunds of any of these gift taxes have been made by the Commissioner or appellee. [R. 64.]

Specification of Errors.

1. The primary basis for the lower court's decision that there was no legitimate purpose for the gifts or the creation of the partnership, is contrary to the facts and evidence.

2. The lower court's finding of fact that the children contributed no capital, that capital was not a material income-producing factor and that all of the income of the business was produced by the services of Elgin R. Parker, is contrary to the facts and the evidence.

3. The lower court's finding of fact that the appellants continued to have sole control of the business and that the gifts and partnership did not change the control of the business, is contrary to the law and to the facts and the evidence.

4. The lower court erred in finding or holding that the gifts and partnership made no real change in the economic or financial status of the Parker family.

5. The lower court's finding that the parties did not intend to join together as partners, is not supported by any evidence, but is directly contrary to the uncontradicted evidence and is based upon the erroneous ultimate findings referred to above.

6. The trial court's finding that capital produced no income and that all income of the partnership was pro-

duced by the services of Elgin R. Parker, is doubly erroneous for the period after April 30, 1946, when the partnership became a passive property-holding enterprise.

Summary of Argument.

Under the Internal Revenue Code, income from property is taxable to the owner of the property and to no one else. Where capital is a material income-producing factor, the owner of a capital interest in a partnership is taxable on his distributive share of partnership income, after reasonable compensation has been paid to the partner who renders services to the partnership business.

All of those factors are present here. The lower court disregarded the uncontradicted evidence and the late decisions of this court and pronouncements of the Federal Legislative Committees and admissions against interest by the Commissioner of Internal Revenue. The lower court ignored the correct principles and demanded stricter requirements than the above authorities require, brushed aside capital as an essential factor and erroneously concluded that the services of Elgin R. Parker produced all the partnership income.

The lower court ignored this court's decisions on fiduciary control and liberalization of partnership requirements, and hence erred in its decision that the appellants did not make the children partners with a bona fide business purpose.

ARGUMENT.

I.

The Gifts Were Made and the Partnership Was Formed for a Legitimate Business Purpose.

The lower court's finding of fact on motive is set out in Finding No. XI which reads as follows:

"Plaintiffs had no business purpose in making the deeds of gift to their children or in the creation of the general partnership. Plaintiffs' sole, expressed purpose was to help the children and to provide an inducement for the children to enter the business of the family. This expressed purpose is not credible and lacks foundation when considered in light of the fact that plaintiffs created a general partnership which rendered the entire interest of the children subject to claims of creditors and in light of the tender ages of the children during the period of the partnership involved herein. To this date none of the plaintiffs' children has actively entered into the business of the plaintiffs or even expressed a determination so to enter the business when he is of age." [R. 52.]

The uncontradicted testimony was that the earlier bankruptcy of the appellants had generated in them a strong desire to give some security to their children. (This brief, p. 4.) The only available asset was an interest in their business.

They gave interests in the business to their children and formed a general partnership. The purpose of using a general partnership, as distinguished from a limited partnership, was to allow the children, through their guardian, under the supervision of the court, to participate in the management and control of the business.

The appellees strenuously argued in the lower court that the appellant's alleged desire to give the children security was not credible because as general partners the children's interests would be subject to the business debts. The appellees in arguing this point stressed that the appellants had once been bankrupt. But the appellees and the lower court failed to take into consideration the fact that the heater business had always been profitable under the management of Elgin R. Parker and that it was expected it would continue to be so under his management after 1943. (This brief, p. 3.) It was only the real estate ventures of the appellants which had forced them into bankruptcy and this new partnership was not organized to engage in real estate transactions. It was expected that the heater business would be profitable and the children would build up estates and that those estates would not be subject to the appellants' debts in real estate or other speculative transactions.

The plan has in fact worked out in exactly that manner. The business has been profitable (it was profitable beyond expectations) and the children have estates exceeding \$100,000 each, with income of around \$7,000 per year. (This brief, p. 6.) Hence the appellees and the trial court have missed a significant portion of the factual background; namely, that the heater business had always been profitable and it was their real estate ventures only which threw the appellants into bankruptcy.

This court in *Snyder v. Westover*, 217 F. 2d 928, and in *Pike v. United States*, 231 F. 2d 688, recognized minor children as partners in *general* partnerships. The desire there was to benefit the children and neither the lower court nor this court held that the desire was incredible because as general partners the children's interests would

be subject to the debts of the business. The Government announced that it would not apply for certiorari, in the *Pike* case, 1956 Prentice-Hall, Paragraph 71,086.

There is, of course, no absolute security in this world, as the interests of even limited partners may be washed away; stocks and even bonds may become worthless, shrink in value, or lose their purchasing power.

Appellants gave their children portions of what they had and gave it in the hope and expectation that the assets would produce income in the future as they had in the past. The appellees and the lower court are unreasonable in looking only at the possibility of failure and not at the reasonable expectation of success of the enterprise.

Furthermore, the other objective of the appellants may be realized. The two minor sons are now approaching manhood; one is in junior high school and the other is in college, and both are planning educational programs which would be most useful in the business. The older son is taking a course in Commerce and the younger son in Engineering. This business employs accountants, salesmen, executives and engineers. The commercial and engineering education of these sons would be most helpful to them in caring for and expanding the business in which the family is engaged. It is true that the boys are not absolutely certain yet that they will make this business their lifetime careers, but they feel more inclined to do so because they have an interest in the business and also have a responsibility to their sisters and to their parents in their old age. (This brief, pp. 6-7.) [R. 91.]

Hence, both of the objectives of the appellants are likely to be crowned with success.

The boys have worked in all phases of the business during summer vacations. They talk with their parents about the business and when they finish school they will be well prepared to carry on the business. (This brief, p. 7.)

However, the consuming desire of the parents to provide some security for their children was the paramount motive in making the children partners. This is a legitimate motive.

Flo Parker did not realize any of the tax consequences of the gifts and did not realize that the income tax of the family might be reduced by the division of income. [R. 93.] Elgin R. Parker realized these points but he would have made the gifts even if such had not been the case. [R. 86.] His desire to give security to the children was the paramount purpose in making the gifts.

The trial court recognized that the paramount purpose of the gifts was to give security to the children and that any tax benefit was incidental. At the end of the trial, on commenting on the case, the court said:

“If the business purpose was achieved, then the fact that incidentally a tax benefit was derived would not destroy the original business purpose.” [R. 183, 184.]

(The trial court eventually erred in determining what was a valid business purpose.)

The Commissioner of Internal Revenue in Mimeo-graph 6767 I. R. B. 1952-1, p. 111, recognizes the same proposition. In paragraph 3, page 117, he says:

“The presence of a tax avoidance motive, is of no consequence if the reality of the transfer of interest and good faith of the parties are satisfactorily established.”

It is submitted that the motive in making the gifts and creating the partnership in this case was legitimate.

In *Snyder v. Westover, supra*, the father made gifts of interests in a business to the children for his own benefit; namely, to assure that he would not lose all of his interest in the business through litigation with his wife. The purpose there was more selfish than the purpose of appellants of benefiting their children, but this court held that there was a bona fide business purpose. In *Nicholas v. Davis*, 204 F. 2d 200, 202 Cal. App. 10, the court said that a similar purpose there was “* * * for a legitimate, and, indeed, a commendable business purpose.” In *Pike v. United States, supra*, the purpose of making the children partners was to treat them fairly by giving them interests in a new venture. The gifts were made to the children in order to benefit them. It was argued that they could not have been left out of the new partnership without causing them an injustice. But if there could have been any injustice in leaving them out it would have been because the corporation distributed assets or rights to only part of the stockholders. If the corporation transferred any benefits to the partnership, the Commissioner should have taxed the partnership income to the corporation or taxed the benefits to the adult stockholder partners as dividends and, since he did not do so, it is assumed that the corporation did not give up any valuable rights. Hence the children had no right to receive further gifts of cash and be made partners. However, their capital was needful and useful to the partnership, and was all the business purpose necessary to recognize them as partners.

The desires to give the Parker children some security and to interest them in joining the business are legitimate motives and business purposes.

It is not necessary that the donees render services or contribute additional capital, nor that the business be benefited. (*Snyder v. Westover, supra*; *Henslee v. Whitson*, 200 F. 2d 540; *House of Representatives Report 586*, 82d Congress, First Session, Section VM (June 18, 1951); *Mimeograph 6767, supra*.) The latter ruling, page 117, says:

“The Bureau considers that the test of business purpose may be satisfied with the single fact (if it be a fact) that the alleged partner has invested in the business money or property, useful to the business, of which he or she is the real owner under the principles stated in Section 1 hereof even though said property or money had already been used in the business before the alleged partners acquired any interest therein.”

On the same page the Bureau says there need be no business purpose for *intra*-family gifts before the donee is recognized for income tax purposes as owner of the property given him. Certainly the facts in the case at bar satisfy the test of legitimate business purpose set out by the Bureau as well as by the Congressional Committees and of this court and the Supreme Court of the United States.

II.

The Children's Capital Was Necessary and Useful to the Business and Produced Income for the Children.

The trial court made findings with respect to capital of the business and of the children as follows:

Finding Number X:

"All of the capital used in the operation of the business of the Southern Heater Company came from the operations and profits of the company. None of the capital originated from sources outside the business. Neither Flo Parker nor the children contributed any capital toward the operation of the business. The amount of capital in the business was not changed in any way because of the creation of the guardianships or because of the deeds of gift to the children on October 31, 1943. Although Elgin R. Parker ostensibly represented the children as their guardian, he did not operate the business after November 1, 1943, in any manner different from the way it had been operated prior to November 1, 1943." [R. 52.]

Finding Number X is clearly erroneous when it says that neither Flo Parker nor the children contributed any capital toward the operation of the business.

The facts show clearly and without contradiction that as of November 1, 1943, the old partnership had been dissolved and the new one was created. Appellants and the four children owned undivided interests in certain assets and these were contributed to the new partnership, the children contributing 50% thereof and the parents 50%. The finding that the children did not contribute any capital toward the operation of the business is absolutely erroneous. Prior to the contributions, the new

partnership had no assets and no capital but it received contributions from the respective partners. (P. 5, this brief.)

Finding Number XV:

“During the fiscal years ended October 31, 1945, 1946, 1947 and 1948 the income of the Southern Heater Company was produced entirely as the result of the personal services of Elgin R. Parker and of the capital which the Southern Heater Company had at the commencement of the partnership and which was additionally accumulated from retained earnings. Capital was not a material income producing factor of the Southern Heater Company during the years involved.” [R. 53, 54.]

Finding Number XV to the effect that capital was not a material income-producing factor of the Southern Heater Company during the years involved is completely erroneous and is contradicted by the first sentence of that finding which states that the income was produced from the personal services of Elgin R. Parker *and of the capital* which the Southern Heater Company had at the commencement of the partnership and which was additionally accumulated from retained earnings.

Finding Number XVI:

“All of the income from the partnership business allocated to the guardianship estates for the Parker children was earned by Elgin R. Parker. The partnership made no real change in the economic or financial status of the Parker family.” [R. 54.]

Finding XVI is erroneous in that it states that all of the income of the partnership allocated to the children was earned by Elgin R. Parker and that the partnership made no real change in the economic or financial status of the Parker family.

Elgin R. Parker testified that in a manufacturing business it was necessary to have a plant in which the goods were manufactured and that it was necessary to have machinery, inventory and working capital. The goods were sold on credit and the company had to have sufficient money to meet its payrolls and to pay for its materials, taxes and other expenses prior to collection of the sale proceeds. He also testified it was necessary for the company to have cash on hand sufficient to buy steel when it was available, as it was not always available during the war period. (P. 7, this brief.)

The court will no doubt take judicial notice of the fact that a manufacturing business has to have capital and manufacturing assets. This was the uncontradicted testimony in the case at bar.

The statement of facts shows that the business had a capital of approximately \$200,000 [R. 163, 164], at the beginning of the partnership and this was increased through retained earnings until at the end of the partnership the net worth of the business was \$676,719.00. [R. 133.] The partnership paid its employees the amounts necessary to retain their services and paid Elgin R. Parker a salary of \$12,000 a year which was believed to be adequate and reasonable. This was as much as he had obtained from the prior partnership and as much as he had ever earned in working for others and twice as much as the company paid any other executive. While the income of the partnership increased during the war years, it is uncertain whether the increase was due to excellent management or to the war conditions and the luck of the company in getting steel, while many of its competitors were forced out of the heater business, or voluntarily went into war work.

In the complaints and amended complaints appellants offered the court or the appellees the opportunity to adjust, under Mimeograph 6767, *supra*, page 120, Elgin R. Parker's \$12,000 salary if they thought it was excessive or inadequate [R. 11, par. XXI, R. 14, par. IX], but neither took any action to do so. The Commissioner of Internal Revenue used it himself for gift tax purposes. (P. 4, this brief.)

Since labor and management have been adequately paid for the services rendered to the partnership, it is obvious that all of the remaining income was due to the capital invested in the business. This is particularly true after April 30, 1946, for after that time the partnership was not active but merely owned land and building which were leased for \$30,000 per year net to Southern Heater Corporation, and stocks of the two manufacturing companies. Not much management was required and Elgin R. Parker was paid \$200 per month for handling the passive affairs of the partnership. It is obvious that the income from this date on was attributable solely to the capital of the partnership. (P. 9, this brief.)

Prior to that time there could have been some question as to whether the management was inadequately or excessively compensated, but neither the appellees nor the court made any serious objection to the salary paid.

The children contributed to the partnership the capital that was given to them by their parents on October 31, 1943, and they thereafter made original contributions of their retained earnings (p. 8, this brief), as found by this court in *Parker v. Westover*, 221 F. 2d 603, 606. Other courts have held that retained earnings constitute original capital. (*Blalock v. Allen*, 100 Fed. Supp. 867;

Yost v. Commissioner, 190 F. 2d 183 (C. A. 5); *Max Kaplan*, 12 T. C. M. 4.)

The Probate Court approved of this retention of earnings on the ground that the retained earnings were needed for the growth of the business, and so invested were much more profitable than if the money had been invested elsewhere. [R. 97, 137, Pltf. Exs. 13, 14.] The income allocated to the children from the partnership was the income from their capital. It was taxable to the owners of the capital and taxable only to them. This principle has been well recognized by this court in *Parker v. Westover*, 221 F. 2d 603; *Toor v. Westover*, 200 F. 2d 713, 716; *Commissioner v. Brodhead*, 210 F. 2d 652; *Commissioner v. Sultan*, 210 F. 2d 652; *Commissioner v. Eaton*, 210 F. 2d 653; *Snyder v. Westover*, 217 F. 2d 928; *Pike v. United States* (C. A. 9), 231 F. 2d 688, and by the *Congressional Committees*, House of Representatives Report No. 586, 82d Congress, First Session, Section VM, June 18, 1951, and by the Commissioner, as shown in *Mimeograph* 6767, CB 1952-1, pages 111, 116, 117. In *Toor v. Westover*, *supra*, this court held that it was proper to refer to the legislative history of the Revenue Act of 1951 in seeking to arrive at the status of the law for years prior to 1951.

The Supreme Court in *Commissioner v. Culbertson*, 337 U. S. 733, 737, said that Sections 11 and 22(a) of the Internal Revenue Code demand that:

“* * * he who presently earns the income through his own labor and skill and utilization of his own capital be taxed therefor.”

The children owned their interests in the business which produced income and they, and not the appellants, are taxable on such income.

III.

**The Children Really and Truly Owned and Controlled
Their Property and Income.**

The trial court made erroneous findings of fact concerning this point as follows:

Finding Number XVI reads:

“The partnership made no real change in the economic or financial status of the Parker family.”
[R. 54.]

Finding Number IX reads as follows:

“Although Elgin R. Parker, as guardian of the children’s estates, filed annual reports with the Superior Court, he exercised sole control in the operation of the Southern Heater Company and subsidiary corporations.” [R. 51.]

Finding Number X reads in part as follows:

“Although Elgin R. Parker ostensibly represented the children as their guardian, he did not operate the business after November 1, 1943, in any manner different than it had been operated prior to November 1, 1943.” [R. 52.]

Finding Number XII reads as follows:

“The creation of the general partnership following the deeds of gift to the children of an interest in a going business affected the titular ownership of the business and the legal form but not the economic substance thereof. The addition of partners after October 31, 1943, had no business effect whatsoever on the operation of Southern Heater Company.” [R. 53.]

It will be noted that the trial court made no finding that the children did not actually own their interests in

the business. The court did state that the parents had treated the children fairly in the allocation of their income.

The real views of the trial court, contrary to the findings of fact signed at the instance of the appellees, are shown from comments made at the end of the trial which are found in the record as follows:

“Each of these cases has its own peculiarities, which have to be considered. There are many elements which have developed in the trial which did not exist in some of the other cases. Perhaps one of the most significant is that there is no general power such as existed in some of the others, of the managing partner to terminate the partnership or make disposition of the profits except in accordance with the general partnership agreement.” [R. 182.] (The agreement and the law of partnerships put voting control in the court for the protection of the children—four votes to two for the appellants.) (Matter in parenthesis supplied.)

Later the court said:

“There is a provision for dissolution at the request of any of the partners [Art. 4 of Pltf. Ex. 3], but that is one of the grounds contained in the law of California which has adopted the Uniform Partnership Law and there is also a provision to which I have alluded before, that other than on dissolution, equal rights existed as to the other partners when it came to transferring interests, that is, a provision is made whereby upon any sale an opportunity be given to the others to purchase within a period, as I remember, of 90 days and other than borrowing money for tax purposes, there is no power in the partnership for the managing partner to treat the minors in any other manner than he himself and

his wife would be treated so that, although the managing partner exercised the general control of any general partner, there is a provision that additional salaries and bonus may be voted, and it provides that it shall be done on the vote of the partners." [R. 182, 183.] (Matter in parenthesis supplied.)

The court also said:

"It is also a fact that so far as the transfer of a partnership interest is concerned, it not only was irrevocable, but has remained such and in one form or another the interests of the minors have continued throughout the minority, and as to the two children who are minors at the present it still continues." [R. 83.] (This is proof of bona fide ownership by the children; not sham.) (Matter in parenthesis supplied.)

Again the court said:

"There are many elements present in some of the other cases, some of which I, myself, have decided, which simply are not present here. One of the most significant ones is that except through failure the father had no way of milking the business, as it were, or even of exacting unreasonable compensation for his services or forcing a sale. All the conditions were equal. Whatever right he had, the others had." [R. 186.] (The purpose of *Mim. 6767, supra*, and the Revenue Act of 1951 was to recognize children as partners when they really own interests in a business, regardless of the motives which actuated the transfer. Senate Report No. 781, 82nd Cong., First Session, Sec. VI A.1.) (Matter in parenthesis supplied.)

"It is true in a sense he dealt with himself, but even a probate court, exercising its advisory duties

in the most cursory manner could not have allowed, under the wording of the partnership agreement, following the gift, any of the exploitation of the estate of the type which was present in some of the other cases.” [R. 186.]

In other words, the trial court recognized that this was a general partnership and that the powers and rights and liabilities of each partner were absolutely equal and mutual. It recognized that Elgin R. Parker, pursuant to sound business policy (*Ardolina v. Commissioner* (C. A. 3), 186 F. 2d 176), took the lead in the management because of his experience and he did so simply as a general partner. The partnership agreement did not give him any special powers or authorities or advantages. (See *Snyder v. Westover*, *supra*, p. 935.) He had no right to get back any of the property that the parents had given to the children or the income therefrom, either by express provisions or by any other more devious ways. There was no possibility for “kickbacks” and this was not an “Indian gift”. There were no “under-the-table” maneuvers but everything was absolutely straightforward and above-board. The substance was identical with the form—there was no “sham”. The Probate Court protected the children’s property interests.

The father, Elgin R. Parker, as a general partner, operated in a fiduciary capacity as a partner operating for the other partners. Furthermore, he had a second fiduciary relationship as guardian under the supervision of the court. Even as a general partner operating for the others he had a fiduciary capacity which this court recognized in *Toor v. Westover*, 200 F. 2d 713, 715, where this court said:

“We believe that there is a basic difference between control exercised with unlimited discretion only

for one's personal benefit, and control exercised only in a fiduciary capacity as a general partner in a limited partnership. See *California Corporations Code* 15,509; 20 *Cal. Jur., Partnerships*, Section 44. This principle has now been recognized by the *Treasury Department, Mimeograph* 6767, 1952-1, *Cumulative Bulletin*, Page 111."

The *California Corporations Code*, Section 15509, provides that the relation of partners to each other is confidential and of a fiduciary character even with respect to general partnerships.

When the trial court in its decision said:

"* * * the conclusion must be * * * that the business was continued to be controlled by the parents who created it, * * *" [R. 33],

it was ignoring a pronouncement of this court in *Toor v. Westover, supra, Mimeograph* 6767, I. R. B., 1952-1, paragraph 1(d), pages 114, 115, and the effect of the California law on guardianships.

As a matter of fact, under the law the control of the business changed from the appellants to the Superior Court, and thus to the children. No stronger proof could be found of the parents' intention to make the children partners than to give away the control of the business.

It is recognized that the children-donees need not control the business (they may be limited partners, *Marcus v. Commissioner* (C. A. 5), 201 F. 2d 850), it is only necessary that they control their property interests in the business and the income therefrom. They did this through the Probate Court. In *Mimeograph* 6767, C. B. 1952-1, page 114, it is stated:

"It is not uncommon in ordinary business relationships for one partner to be made managing part-

ner or to have voting control, and retention by the donor of control of business management or of voting control standing alone, is of little significance unless the donee either legally or in a practical sense would not be free to withdraw his or her interest whenever dissatisfied with the way in which the business is being conducted * * *

The Parker children could sell their interests or dissolve the partnership, if their controlling vote through the court did not get them proper management. (P. 10, this brief.)

Since the children became the owners of capital which was useful and necessary in the operation of the business and the children really and truly owned and controlled their capital, the lower court's finding that the partnership made no change in the economic or financial status of the Parker family is completely erroneous. The Internal Revenue Code does not treat a family as a unit but merely treats with individuals. Each of the individuals of the Parker family had his economic and financial status changed by the gifts and by the partnership and hence the family had its financial and economic circumstances changed. The parents were only one-half as well off as they were before, and the children owned a half interest in the business and derived considerable income therefrom, whereas before they had nothing. The appellants supported the children and themselves out of half the income, instead of having all of it subject to appellants' dominion. These factors show a bona fide change of economic status. (*Seabrook v. Commissioner* (C. A. 5), 196 F. 2d 322; *Thomas H. Brodhead*, 18 T. C. 726; *Mimeograph* 6767 C. B. 1952-1, 111.)

The recent decisions of this court, as well as the Legislative Record of the 1951 Act and the Commissioner's Mimeograph 6767, make clear that the real issue in these family partnership cases is not the motive or reason why the parents made gifts to the children or whether the parents continued to run the business or whether the children contributed new capital or vital services, but whether the children became the real owners of their interests in the business.

This court recognized that principle in *Parker v. Westover*, *supra*, where in footnote 4 on page 607, it referred to the legislative history as follows:

"* * * Your Committee's amendment makes it clear that, however the owner of a partnership interest may have acquired such interest, the income is taxable to the owner, if he is the real owner.
* * * Senate Report No. 781, 82d Congress, First Session, Section VI A7 (1951); H. R. Report 586, 82d Congress, First Session, Section VM (1951)."

This court in *Commissioner v. Brodhead*, 210 F. 2d 652, affirmed the decision of the Tax Court in 18 Tax Court 726 on the grounds and for the reasons stated by the Tax Court. The Tax Court, among other things, page 735, said:

"The attribution of income from property to the owner of the property was emphasized by the tax committees of the House of Representatives and of the Senate in their consideration of the family partnership provisions that became Section 340 of the Revenue Act of 1951. It was the expressed view of the Committees that the partnership income, where capital is a material income-producing factor, should be taxed to the partners if they were the real owners of their interests, regardless of how the interests may

have been acquired. * * * Nevertheless, the basic principle of taxing income from property to the owner of the property was the law in the earlier years as fully as it is today. * * *” (This principle was pronounced by this court in *Toor v. Westover*, 200 F. 2d 713, 716.)

The Commissioner has announced his acquiescence in the *Brodhead* case, Internal Revenue Bulletin No. 5, dated November 30, 1955, page 7.

The trial court in its decision refused or failed to recognize that there has been any light thrown on the law of family partnerships since the Supreme Court decision of *Commissioner v. Culbertson*, *supra*. The trial court has refused to recognize the pronouncements of this court on the subject, or the view taken of it by the Congressional Committees, or the admissions against interest by the Commissioner in his *Mimeograph 6767*, *supra*.

The trial court in its discussion at the end of the trial has clearly shown that it thought that the children were the true owners of their interests in the business and, through the Probate Court, controlled their property and income therefrom and were fairly treated by the parents in that respect. In other words, the court thought that the children really and truly owned their interests in the business.

Courts have given considerable weight to various customary incidents of firm membership which are present in the instant case, such as sharing of losses, *Bratton v. Commissioner* (C. A. 10), 193 F. 2d 416; *Phillips*

v. United States (C. A. 5), 193 F. 2d 132; *Stanchfield v. Commissioner* (C. A. 8), 191 F. 2d 826; the form of bookkeeping employed, annual accountings, audits, and whether there is or will be a pro rata division of firm assets upon dissolution. (*Ardolina v. Commissioner* (C. A. 3), 186 F. 2d 176.)

The court has misapplied the tests as to family partnerships, has erred with respect to the effect of the continued management of business by one of the general partners, has erred with respect to the contributions by the children to the capital of the business and has signed, at the instance of the appellees, findings of fact which contradicted what the court had previously said. The trial court has refused to accept the recent trend in the law established by this court and has insisted upon harsher tests of business purpose than the Commissioner in his own Mimeograph requires and has thus reached a decision which is contrary to the real facts and to the proper application of the law. The children were really and truly owners of their interests in the business and were partners and they should be taxed on their income from the partnership.

As the Supreme Court in the *Culbertson* case, 337 U. S. 733, said, pages 744 and 745:

"If, upon a consideration of all the facts, it is found that the partners joined together in good faith to conduct a business, having agreed that the services or capital to be contributed presently by each is of such value to the partnership that the contributor should participate in the distribution of profits, that is sufficient."

Conclusion.

We submit that this partnership should be recognized for income tax purposes, within the principles established by the Supreme Court in the *Culbertson* case, by this court in several recent cases, by the Legislative History back of the Internal Revenue Act of 1951 and by the Commissioner's admissions in Mimeograph 6767. The judgments below should be reversed.

Dated: April 4, 1957.

MELVIN D. WILSON,

Attorney for Appellants.



APPENDIX.

Section 181 of the Internal Revenue Code of 1939 (26 U. S. C. A.) reads as follows:

"Section 181. Partnership Not Taxable. Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity."

"Section 182. Tax of Partners. In computing the net income of each partner, he shall include, whether or not distribution is made to him * * *"

"His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in Section 183(b)."

Section 22 of the Internal Revenue Code of 1939 reads in part as follows:

"Section 22. Gross Income.

"(a) General Definition—'Gross income' includes gains, profits, and income derived from salaries, wages, or compensation for personal service (including personal service as an officer or employee of a State, or any political subdivision thereof, or any agency or instrumentality of any one or more of the foregoing), of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *"

Section 3797 (a) (2) of the Internal Revenue Code of 1939 defines a partnership and a partner as follows:

“The term ‘partnership’ includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term ‘partner’ includes a member in such a syndicate, group, pool, joint venture, or organization. * * *”

No. 15340.

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

MAY 8 - 1957
ELGIN R. PARKER and FLO PARKER,

Appellants,

vs.

HARRY C. WESTOVER, individually and as Former Collector of Internal Revenue for the Sixth District of California,

Appellee.

ELGIN R. PARKER and FLO PARKER,

Appellants,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles, California,

Appellee.

On Appeal From the Judgments of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEES.

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MAY - 8 1957

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Appellants,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles, California,

Appellee.

On Appeal From the Judgments of the United States District Court for the Southern District of California.

BRIEF FOR THE APPELLEES.

Opinions Below.

The findings of fact, conclusions of law, and opinion of the District Court [R. 31-33, 47-56] are reported at 144 F. Supp. 933. A supplemental opinion [R. 33-34] is not officially reported.

Jurisdiction.

These consolidated appeals involve deficiencies in federal income taxes for the calendar years 1945, 1946, 1947 and 1948, in the aggregate amount of \$282,164.96. [R. 48, 194.] Timely claims for refund were filed and, within

the time provided in Section 3772 of the Internal Revenue Code of 1939, taxpayers filed suits for recovery of the taxes paid. [R. 48.]¹ Jurisdiction was conferred on the District Court by 28 U. S. C., Section 1340.

The judgment of the District Court was entered on July 12, 1956, and taxpayers filed a notice of appeal on August 13, 1956. [R. 56-57.] The jurisdiction of this Court is invoked under the provisions of 28 U. S. C., Section 1291.

Question Presented.

Whether the District Court erred in concluding, upon all of the evidence, that the taxpayers did not intend, in good faith and acting with a business purpose, to enter into partnership, during the years 1945 through 1948, with the guardianship estates established for their minor children.

Statutes and Regulations Involved.

The Statutes and Regulations involved are set forth in the Appendix, *infra*.

Statement.

The findings of fact [R. 48-55] of the District Court may be summarized as follows:

Beginning in November, 1942, and until October 31, 1943, taxpayers Elgin R. Parker and Flo Parker, who are husband and wife, operated, as a partnership, a busi-

¹The deficiencies asserted against taxpayer Elgin R. Parker for the years 1945 and 1946 were paid, abated or satisfied by credits in installments and on the dates shown in Exhibit A, attached to the answer to his complaint. [R. 20, 24-25, 28-29.] Details with respect to payments made by both taxpayers for the years 1947 and 1948 are set forth at R. 173-176.

ness known as Southern Heater Company, which consisted of the manufacturing and selling of gas water heaters.² Each taxpayer owned a one-half interest in the partnership. [R. 49.]

On October 31, 1943, taxpayers, by written deeds of gift, each gave to each of their then four minor children an undivided one-eighth interest in the partnership then conducted by them. [R. 49.]³

On November 1, 1943, Elgin R. Parker petitioned the Superior Court of Orange County, California, wherein the taxpayers were then residing, for an appointment of himself as guardian of the assets of his four children, which had been transferred to these children by the deeds of gift. This petition was granted and an order appointing the father as guardian of his children was made by the Superior Court on December 31, 1943. After his appointment as guardian, Elgin R. Parker, with the consent of the Superior Court, entered into a general partnership agreement between himself as guardian of his four children, himself as an individual, and his wife, Flo Parker, for the purpose of carrying on the business of the Southern Heater Company. This general partnership agreement was effective November 1, 1943, the day after the deeds of gift to the children. The business of the Southern Heater Company was continued after November 1, 1943, in the same place with the same capital under the same management of Elgin R. Parker. [R. 50.]

²Prior thereto, taxpayer Elgin R. Parker had been engaged in the business as sole proprietor. [R. 49, 92.]

³A fifth child born in 1945 is not involved in these proceedings. [R. 49.]

Starting with little capital, taxpayer Elgin R. Parker had increased the income of the Southern Heater Company from the date of its inception in the late nineteen thirties until October 31, 1943, so that for the fiscal year ended October 31, 1943, the Southern Heater Company showed a net profit of \$193,000. Subsequent to the formation of the partnership on November 1, 1943, the net income of the Southern Heater Company was as follows: Fiscal year ended October 31, 1944, \$263,928.92; fiscal year ended October 31, 1945, \$229,646.15; fiscal year ended October 31, 1946, \$307,983.48; fiscal year ended October 31, 1947, \$26,696.66; fiscal year ended October 31, 1948, \$57,629.12. [R. 49, 50.]

Despite the large partnership earnings and profits during the years in question the only disbursement to the guardianship estate out of the business profits was a disbursement of \$3,750 in United States war bonds to each of the four children during the year 1945. At the termination of the partnership on October 31, 1948, the only assets which the children had in their guardianship estates were stocks in various corporations, and notes given by the taxpayers for monies borrowed by the parents from the guardianships. The corporations had been formed in 1946 and succeeding years to take over certain partnership assets and operations in exchange for their stock which the partnership held. [R. 51.]

The Commissioner of Internal Revenue determined that all income earned by the Southern Heater Company during the fiscal years ended October 31, 1944, through October 31, 1948, was taxable to the parents and that the partnership arrangement was merely a reallocation of income within the family group. At the same time the Com-

missioner determined that there had been overassessments of the taxes paid by the guardianship estates for the calendar years 1944 through 1948. With the approval of the Superior Court, taxpayers borrowed the refunds due the children and applied them toward additional taxes resulting from the Commissioner's determination. Notes were issued for the sums borrowed. [R. 53.]

Although Elgin R. Parker, as guardian of the children's estates, filed annual reports with the Superior Court, he exercised sole control in the operation of the Southern Heater Company and subsidiary corporations. Whereas he ostensibly represented the children as their guardian, he did not operate the business after November 1, 1943, in any manner different from the way it had been operated prior thereto. Permission of the Superior Court was neither sought nor obtained for the operation of the business. At no time was any act of Elgin R. Parker as guardian in the guardianship proceedings opposed by any party nor was any petition or request by him to the Superior Court denied. [R. 51, 52.] Furthermore, neither the children nor Flo Parker contributed any services to the partnership at any time, nor did they participate in the management or control thereof. [R. 51.]

All the capital used in the operation of the business of the Southern Heater Company came from the operations and profits of the company. None originated from sources outside the business. Neither Flo Parker nor the children contributed any capital toward the operation of the business. The amount of capital in the business was not changed in any way because of the creation of the guardianships or because of the deeds of gift to the children on October 31, 1943. [R. 52.]

During the fiscal years ended October 31, 1945, 1946, 1947 and 1948, the income of the Southern Heater Company was produced entirely as the result of the personal services of Elgin R. Parker and of the capital which the company had at the commencement of the partnership and which was additionally accumulated from retained earnings. Capital was not a material income-producing factor of the company during the years involved. [R. 53-54.]

Taxpayers had no business purpose in making the deeds of gift to their children or in the creation of the general partnership. Their sole expressed purpose was to help the children and to provide an inducement for the children to enter the business of the family. This expressed purpose was not credible and lacked foundation when considered in light of the fact that taxpayers created a general partnership which rendered the entire interest of the children subject to the claims of creditors and in the light of the tender ages of the children during the partnership period. Moreover, none of the children has actively entered into the business or even expressed a determination to enter the business. [R. 52.] At the time the gifts were made, taxpayer's four children were fourteen, eleven, six and three years old. [R. 49.]

The creation of the general partnership following the deeds of gift to the children of an interest in the going business affected the titular ownership of the business and the legal form but not the economic substance thereof. The additional partners after October 31, 1943, had no business effect whatsoever on the operation of the Southern

Heater Company. [R. 53.] Neither did the partnership effect any real change in the economic or financial status of the Parker family. All the income from the partnership business allocated to the guardianship estates for the Parker children was earned by Elgin R. Parker and merely amounted, as the Commissioner determined, to a reallocation of income within the family group. [R. 53, 54.]

The District Court found as an ultimate fact that, considering all the facts—the deeds of gift, the partnership agreement, the conduct of the parties, the execution of the provisions of these gifts and agreement, statements and testimony of the witnesses, the relationship of the parties, their respective abilities and capital contribution, the actual control of the income allocated to the guardianship estates and all other facts throwing light on their true intent—the parties did not in good faith and acting with a business purpose intend that the guardianship estates should join together with the taxpayers herein in the present conduct of the partnership enterprise known as the Southern Heater Company. [R. 54-55.]

Accordingly, it concluded that taxpayers failed to sustain their burden of proving that, in good faith and acting with a business purpose, they intended that their children or Elgin R. Parker, as guardian of the children's estates, join together with them as partners in the conduct of the Southern Heater Company; that they were not partners in the operation of the business; that none of the income from the business should be attributed to Parker as guardian of the children's estates or to the children them-

selves; and that taxpayers did not overpay their federal income taxes for the years 1945, 1946, 1947 and 1948. [R. 55-56.]

Upon the basis of its findings and conclusions, the District Court entered judgment dismissing the complaint. [R. 56-57.]

Summary of Argument.

These cases involve an attempt to avoid federal income taxes by reallocating income among an intimate family group through the instrumentality of an alleged partnership. The question is whether, considering all the facts, the parties, in good faith and acting with a business purpose, intended to join together in the present conduct of a business enterprise. Under controlling law and the facts of record, this question must be answered in the negative, as the District Court found. While no single factor is conclusive, absence of a contribution of original capital by the alleged partners, or of vital services, or of participation in management and control, such as exists here, places a heavy burden on the taxpayers to show that their children were true owners of a partnership interest.

During the alleged partnership years, the children were minors and performed no vital services in connection with the operation of the business. A hope that they might perform such services at some future date is not a basis for the present taxation of income to them.

Neither did the children, through the guardianship estates, contribute any new capital to the business. Their alleged capital contribution consisted of gifts of an interest in a going concern previously owned and operated by their parents. At most, the alleged partners received bare legal title to a part of the business assets, but this

alone is insufficient to render them partners for tax purposes. Nor does the retention of accumulated earnings in the business effect any different result where under all the facts it is clear that they were not the true owners of the gift capital.

The facts also show that the children did not participate in the management or control of the business. As he admitted, their father, taxpayer Elgin R. Parker, continued to run the business as he had prior to the formation of the alleged new partnership. He made all the decisions and neither sought nor obtained the advice or consent of the court having jurisdiction over the guardianship estates with respect to the operation of the business.

Furthermore, the parties did not act with a business purpose. Rather, the sole purpose of taxpayers in entering into the alleged partnership arrangement was to obtain a tax benefit at the expense of the United States. This is apparent from the testimony that Mr. Parker was aware of tax advantages in making the gifts, that it was expected and intended that the children would pay a tax on their share of the income, that if he had realized that it would be held otherwise he would have immediately liquidated the business, and from the fact that taxpayers sought and obtained permission of the probate court to satisfy their tax deficiencies with money from the children's accounts.

Under the facts, then, the District Court had no alternative but to conclude that the parties did not, in good faith and acting with a business purpose, intend to join together as partners in the present conduct of a business enterprise.

ARGUMENT.

THE DISTRICT COURT CORRECTLY DECIDED THAT THE GUARDIANSHIP ESTATES ESTABLISHED FOR THE BENEFIT OF TAXPAYERS' MINOR CHILDREN WERE NOT PARTNERS FOR TAX PURPOSES IN THE OPERATION OF THE BUSINESS OF THE SOUTHERN HEATER CAMPANY.

A. Preliminary Statement.

The prior history of these cases is to be found in the opinion of this Court in *Parker v. Westover*, 221 F. 2d 603. It shows that, by deficiency notices issued in 1947 with respect to the income tax year 1944, the Commissioner of Internal Revenue took the position that the Parker children were not valid partners for tax purposes. Taxpayers paid the deficiencies, filed claims for refund, and brought suit for recovery. A jury trial was had in 1950 which resulted in judgment for the Collector, thereby sustaining the Commissioner's position. In a *per curiam* opinion, this Court affirmed the judgment. *Parker v. Westover*, 186 F. 2d 49.

Subsequently, in 1951, the taxpayers each filed complaints to recover amounts of deficiencies which they had paid with respect to the taxable years 1945 and 1946, pursuant to deficiency notices issued in 1949. The same ground was alleged as for the 1944 deficiency. The District Court dismissed the complaints on the ground of *res judicata*. Upon appeal, this Court reversed, stating two reasons for its conclusion that the rule of collateral estoppel was improperly applied by the District Court.

The first reason related to the fact that subsequent to the jury trial in 1950 an agreement was reached with the Orange County Superior Court as to the parents' claim against the guardianship funds. [R. 103, 104, 156-159.] As stated by this Court (221 F. 2d 603, 606), under this

plan, if the parents won the 1944 tax litigation, they would return to the guardianship estates the amount of the children's income tax refunds which they had borrowed, plus interest; if they lost, they would receive from the guardianship estates amounts necessary to apportion taxes among the partners proportionate to their employment of partnership income.⁴ This Court considered that this agreement represented the settlement of an evidentiary fact question which had been in dispute before the jury in the litigation pertaining to the tax year 1944; that in a trial covering the years 1945 and 1946 "both the taxpayer and the Government will be in a position to argue to a jury the effect of this new evidentiary fact upon the original partnership agreement"; and that because this introduced the possibility of a different verdict, the bar of collateral estoppel was lifted.

Secondly, this Court concluded that the rule of collateral estoppel was not applicable because the District Court had failed to consider (in connection with a claim of change in controlling legal principles) the impact on the case of the amendment of the family partnership provisions of the Internal Revenue Code of 1939 effected by Section 340(a) and (b) of the Revenue Act of 1951, c. 521, 65 Stat. 452, and the committee reports pertaining thereto.

On remand, the cases involving the taxable years 1945 and 1946 were later consolidated with the cases filed by each taxpayer on September 15, 1955, covering the taxable years 1947 and 1948. All four cases were then tried by the court below without a jury, whereupon judgment was entered in favor of the Government. [R. 47-48, 56-57, 194.]

⁴The plan also extended to the litigation involving the years 1945 and 1946. [R. 148-152.]

B. The Record Amply Supports the District Court's Findings and Conclusions.

The sole question presented is whether, for federal income tax purposes, taxpayer Elgin R. Parker as guardian for the estates of his four minor children was a partner in the operation of the business known as the Southern Heater Company or whether the children individually were such partners. The question is one of fact and depends upon the intent of the parties. *Commissioner v. Culbertson*, 337 U. S. 733, 742-743; *Toor v. Westover*, 200 F. 2d 713, 714 (C. A. 9th). The test determinative of that intent is "whether, considering all the facts * * * the parties in good faith and acting with a business purpose intended to join together in the present conduct of the enterprise." *Commissioner v. Culbertson*, *supra*, p. 742. Applying this test, the court below found that they did not [R. 54-55], and the facts of record fully support that finding. Unless this factual conclusion is "clearly erroneous," it may not be disturbed on appeal. *Smith v. Westover*, 237 F. 2d 201, 203 (C. A. 9th). Whether the evidence would have supported a different finding by the District Court is a question not here presented. *Commissioner v. Tower*, 327 U. S. 280, 292.

In the *Culbertson* case, the Supreme Court stressed (pp. 740, 748) the importance of participation in the business by the partners during the tax years through the performance of services or because of contributions of capital of which they were the "true owners." In this regard, failure of the alleged new partners to perform "vital services," or to contribute "original capital," or to participate in "management and control of the business" has the effect of placing "a heavy burden on the taxpayer to show the

bona fide intent of the parties to join together as partners.” *Commissioner v. Culbertson*, *supra*, p. 744. None of these criteria is satisfied in these cases.

1. No Vital Services.

The District Court found that neither the children nor Flo Parker contributed any services to the partnership at any time. [R. 49, 51.] The wife admitted that during 1942 and 1943, prior to the alleged partnership with the children, she was not active in the business, did no work and drew no salary. [R. 92.] The record discloses no different situation after the alleged new partnership was formed, and that is also true with respect to the children. At the time the alleged partnership agreement became effective (November 1, 1943), taxpayers' two sons were aged three and six, and the daughters were eleven and fourteen years of age. [R. 73.] At the time of the trial of this case (May, 1956) [R. 48], the younger son was aged fifteen and a high school sophomore; the older son was aged nineteen and a college freshman. Even in the more recent years not here involved, other than during summer vacations and various odd occasions, neither worked in the business. [R. 67-68, 88-91.] There is no evidence that taxpayers ever expected their daughters to enter the business. [R. 66.] Although both taxpayers testified that their purpose in making the gifts to their children was, in part, to interest them in entering and carrying on the business, neither son was certain that he would enter the business. [R. 61, 89, 90, 93.] It is clear, therefore, that there was no intent that through the performance of services the children would enter into the “present conduct” of the business, and, as stated in *Culbertson* (p. 740): “The vagaries of human experience preclude reliance upon even good faith intent as to future conduct as a basis for the present taxation of income.”

2. No Contribution of Capital of Which the Children Were the True Owners.

The District Court found that capital was not a material income-producing factor of the Southern Heater Company during the years involved. [R. 54.] Taxpayers contend otherwise. (Br. 12.) However, it is not contradicted, as the court below found, that "Starting with little capital" taxpayer Elgin R. Parker had increased the income of the company from \$30,000 at the date of its inception in the late nineteen thirties until October 31, 1943, so that for that fiscal year the company showed a net profit of \$193,000. [R. 49, 71.] This constituted the approximate amount of the beginning capital of the alleged new partnership. [R. 165.] Thereafter, all the capital used in the operation of the business came from the operations and profits of the company, and, as Mr. Parker admitted and the court below found, he operated the business in the same manner after November 1, 1943, as he previously had. [R. 52, 62, 79.] Since, with "little capital" as a beginning, the income from the business increased steadily from 1938 to October, 1943, and further increased during the war years, 1943-1946, and inasmuch as Parker continued to run the business in the same manner after the formation of the alleged new partnership, it would seem to follow, as the court below found, that capital was not a *material* income-producing factor, but rather that the income was produced "entirely as the result of the personal services of Elgin R. Parker and of the capital which the Southern Heater Company had at the commencement of the partnership and which was additionally accumulated from retained earnings." [R. 53-54.] Of course, the mere fact that it was necessary to have "cash" with which to operate [R. 69], does not mean

that capital was a material income-producing factor in the business.

In support of their contention that capital was a material income-producing factor, taxpayers point (Br. 22) to Parker's salary of \$12,000 a year which was received from November, 1943, to May, 1946, when the partnership's manufacturing assets were transferred to two corporations in exchange for their stock. [R. 64, 69.] It is noted, however, that in connection with their claims against the children's estates, it was stated that "The father received a salary of but \$12,000, whereas his services were worth at least \$52,000 per year." [R. 54, 80.] This additional factor lends support to the finding of the District Court, whose function it was to weigh the evidence, draw inferences, and disclose the result,⁵ that capital was not a material income-producing factor.

Even if it be assumed that taxpayers are correct in their contention that capital was a material income-producing factor, nevertheless the children were not the true owners of any business capital such as to warrant taxation of any income earned thereby to them. The position of the Internal Revenue Service for taxable years beginning prior to January 1, 1951, with respect to family partnerships in which capital is a material income-producing factor, is contained in Mim. 6767, 1951-1 Cum. Bull. 111. The aspects of the family partnership problem there discussed and here considered have to do with the question of whether an alleged partner is the real owner of an interest in capital of a partnership which is attributed to him.

⁵*Helvering v. Kehoe*, 309 U. S. 277, 279.

(a) REALITY OF CAPITAL CONTRIBUTION.

It is stated in the Service's mimeograph that (p. 113):

In the ordinary gift capital case, the question whether a donee's partnership interest represents a mere "surface change of ownership," or conversely whether the donee has exercised dominion and control over his or her interest, represents the heart of the issue whether a partnership in good faith was intended, at least in those cases where the donee has not performed substantial services. In turn, all of the elements of the test of good faith intent laid down in the *Culbertson* opinion have an immediate bearing upon the reality of the donee's ownership

* * *

One of the elements having an immediate bearing on the reality of the donee's ownership is his capital contribution. In this regard the presence or absence of "original" capital remains one of the factors to be considered, although, as the mimeograph states (p. 112), "the absence of 'original' capital creates, rather than answers, the problem whether an alleged partner is entitled to recognition." That element of the test, as enunciated in *Commissioner v. Tower*, 327 U. S. 280, and *Lusthaus v. Commissioner*, 327 U. S. 293, and reiterated in *Culbertson*, has not been changed, insofar as concerns the tax years here involved, by the amendment of the law with respect to family partnerships effected by Section 340(a) and (b) of the Revenue Act of 1951, c. 521, 65 Stat. 452. Section 340(a) of that Act amends Section 3797 of the 1939 Code to provide that a person shall be recognized as a partner for income tax purposes "if he owns" a capital interest in a partnership in which capital is a material income-producing factor "whether or not such interest

was derived by purchase or gift from any other person.” However, Section 340(c) of that Act provides that such amendment is applicable only to taxable years beginning after December 31, 1950, and that determination as to whether a person shall be recognized as a partner for income tax purposes for taxable years before January 1, 1951, “shall be made as if this section had not been enacted and *without inferences drawn from the fact that this section is not expressly made applicable with respect to taxable years beginning before January 1, 1951.*” (Italics supplied.) It is clear then that for tax years beginning prior to January 1, 1951, “original” capital remains a factor to be considered in determining the *bona fides* of the true ownership of a partnership interest. For subsequent years, the amendment effected by Section 340 (a) merely makes it clear that regardless of how “the real owner” of a partnership acquired his interest, or what motivated the transfer to him, or whether the business benefited from the entrance of the new partner, the income is taxable to such owner. H. Rep. No. 586, 82d Cong., 1st Sess., p. 32 (1951-2 Cum. Bull. 357, 380); S. Rep. No. 781, 82d Cong., 1st Sess., p. 38 (1951-2 Cum. Bull. 458, 485.

In the instant case, we note, therefore, as pointing to the fact that the children were not the true owners of a capital interest in the partnership, that they did not contribute any original capital. Rather their alleged capital interests arose by way of gifts of an interest in a partnership then being conducted by their parents. [R. 49.] In a memorandum filed with the Superior Court in 1946 in conjunction with taxpayers’ application for compromise of the 1944 tax claims, it was claimed that “The parents furnished all the capital.” [R. 83-85.] The mere fact

that those deeds of gift may have been legally sufficient and irrevocable is not determinative for "Reality and good faith are not ascertainable by any mechanical or formalistic test." Mim. 6767, *supra*, p. 113; *Commissioner v. Culbertson*, *supra*, p. 745; *Feldman v. Commissioner*, 186 F. 2d 87, 91 (C. A. 4th).

Furthermore, to say as taxpayers do (Br. 23) that the children "made original contributions of their retained earnings" assumes that they were the "true owners" of part of the capital contributed to the business and thus begs the question to be decided. Unless it can be said that "considering all the facts" the children really owned the gift capital, they had no retained earnings or profits to reinvest in the business. At most it can only be said that "the retention of partnership earnings with the acquiescence of the donee for the reasonable needs of the business is not inconsistent with *bona fide* ownership by the donee." Mim. 6767, *supra*, p. 115. It does not establish ownership, even assuming that in this case the retention was "with the acquiescence" of the donees, since the two sons, at least, did not even know about the gifts until after the alleged partnership was dissolved. [R. 89, 91.]

(1) *No Participation in Management and Control.*

As pointed out above, the District Court found that the children did not participate in the management and control of the business. [R. 51.] In an attempt to answer this finding, the taxpayers state (Br. 29) that "under the law the control of the business changed from the appellants to the Superior Court, and thus to the children." However, as the District Court pointed out in its findings [R. 51], although taxpayer Elgin R. Parker, as

guardian of the children's estates, filed annual reports with the Superior Court, permission of the Superior Court was neither sought nor obtained for the operation of the business, and at no time was any act of Parker, as guardian, opposed by any party, nor was any petition or request by him to the Superior Court denied. These facts are not denied by taxpayers nor controverted by any facts of record, but rather are supported thereby. [R. 146-147, 149, 150.] As a matter of fact, taxpayer Elgin R. Parker admitted that after the partnership arrangement was accepted by the probate court he continued to run the business as before. [R. 62, 79.] Specifically, he testified that at the time the gifts were made in October, 1943, he was acting as "president and general manager of the entire operation of the business, and after making the gifts my duties were the same"; that although he discussed "vital" matters with his wife and sought instruction from the court on a number of matters, he "did not obtain authorizations from the court for decisions in the regular operation of the business." [R. 79.] Mrs. Parker also testified that she was not active in the business and did not participate in any of the management decisions or other decisions with regard to the operation of the business; and that although Mr. Parker discussed things with her, "he made the decisions." [R. 92.] The guardianship proceeding, then, had no effect whatsoever on Parker's control and operation of the business. It is clear, therefore, that taxpayer Elgin R. Parker exercised sole control in the operation of the Southern Heater Company and subsidiary corporations, as the court below found. [R. 51.]

(2) *Income Distributions and Right to Withdraw.*

Unless Parker instituted the proceedings, the children could neither withdraw from the partnership nor receive actual distributions of income from the business. In fact, except for a disbursement of \$3,750 in United States war bonds to each of the four children, they received no distributions from the earnings and profits of the business during the period of its operation. [R. 51.] On the other hand, taxpayers had borrowed some \$214,000 from the partnership for which they gave notes. [R. 80.] As far as the record shows, those notes were unsecured. As stated in the *Culbertson* opinion, *supra*, p. 747, "Whether he [a donee] is free to, and does, enjoy the fruits of the partnership is strongly indicative of the reality of his participation in the business." Such was not the fact in the case of the children involved herein. Rather, Parker, as general manager and guardian, retained the powers of management and full discretion as to the time and amounts of distributions of profits, and he therefore, together with his wife, remained the substantial owner of the interests purportedly given away. *Toor v. Westover*, 200 F. 2d 713, 717 (C. A. 9th).

3. Motive and Business Purpose.

Referring to the test of intent stated in the *Culbertson* opinion, *supra*, the Internal Revenue Service considers that the test of "business purpose" may be satisfied by the single fact (if it be a fact) that the alleged partner has invested in the business money or property, useful to the business, of which he or she is the "real owner" under principles discussed above, even though such money or property had already been used in the business before the alleged partner acquired any interest therein. *Mim.* 6767, *supra*, p. 117. As we have demonstrated, and as

the District Court concluded [R. 55-56], taxpayers have failed to establish that the children were true owners of any partnership interest under those principles—hence the test of “business purpose” is not satisfied.

The avowed reason given for the making of the gifts to the children was to give them some assets or security which would protect them “in case of any bad business decision of my own or bad business in general,” or in the event of the death of the taxpayers, and to induce them to enter the business. [R. 60, 61, 93.] The facts of the case, however, indicate otherwise. As the court below pointed out [R. 52], this expressed purpose is not credible and lacks foundation when considered in light of the fact that taxpayers created a general partnership which rendered the entire interest of the children subject to the claims of creditors. Parker was aware of this fact. [R. 72, 73-74.] On the other hand, from a tax point of view, the creation of a corporation was not as desirable as the formation of a partnership. During the war years, through 1945, there was in existence a corporate excess profits tax, imposed at the rate of 85½ per cent. It may be argued that taxpayers were cognizant of this in view of the fact that in 1946, after the repeal of that tax, they transferred the operating assets of the business to two corporations.

Neither does the stated purpose of inducing the children to enter the business have any merit as a business purpose, as is indicated above. Rather it is a *personal* purpose. *Hash v. Commissioner*, 152 F. 2d 722 (C. A. 4th), certiorari denied, 328 U. S. 838, rehearing denied, 328 U. S. 879. In a similar situation, this Court refused to sanction an “obvious device” whereby a wife and children were given “ostensible interests for no apparant purpose

except to build up an estate in the children at the expense of the United States.” *Smith v. Westover*, 237 F. 2d 201, 203. The same reasoning and result should obtain herein.

Lack of business purpose is also demonstrated by the presence here of a tax avoidance motive—“one of many factors to be weighed in the determination of the reality of an intrafamily gift * * * and of the existence of *bona fide* partnership intent.” Mim. 6767, *supra*, p. 117. As said in *Commissioner v. Tower*, *supra*, p. 289, a showing that the arrangement was made for the express purpose of reducing taxes “simply lends further support to the inference” that the claimed partnership is unreal. Mr. Parker testified that he was aware that, if there was any profit, there would be a tax advantage in making the gifts [R. 61] and that he and his wife expected when the gifts were made that the children would pay the tax on their share of the income. [R. 70, 141.] Although he also testified that he would have made the gifts regardless of any tax advantages [R. 61, 75, 86], such self-serving testimony is contradicted by other testimony and documentary evidence to the effect that if taxpayers had to pay taxes on all the partnership income “in about three and a half years, starting with 1944, we would have had no interest left in the business and the children would have owned it all”. [R. 70, 140.]

The presence of this tax avoidance motive in making the gifts is also evidenced by the applications filed by taxpayer Elgin R. Parker as guardian of his children’s estates wherein he sought permission of the probate court to apply refunds due the children as well as additional sums of money from the capital accounts of the guardianship estates in payment of the tax deficiencies asserted

against him and his wife. [R. 138-146.] In the absence of any objection to these requests, the permission was granted. The orders of the probate court provided that in the event taxpayers lost their litigation with respect to the incidence of the tax on the income of the partnership, they were to keep and retain the refunds in at least part settlement of their claims against the guardianship estate on account of income taxes, and that if they were successful, they were to pay the refunds to the guardianship estates plus any interest benefits they might have obtained. [R. 146-151.] The second of these orders, dated July 30, 1948, further provided that if the parents eventually lost their income tax litigation, they could keep the refunds payable to the children and have permission to apply for further allowances. [R. 151, 157.] Pursuant to that provision, an order of the probate court was subsequently obtained permitting distribution of an "additional income tax burden" of \$223,913.92 (after giving effect to the refunds given to the four children for the period November 1, 1943, to the dissolution of the alleged partnership on October 31, 1948) "on the family in accordance with the distribution of the partnership income." [R. 103-104, 156-159.] Subsequent reports and decrees in the guardianship proceedings showed the retention of money or assets as a reserve against the claims filed by taxpayers on account of the income tax deficiencies asserted against them. [R. 104-116.] Such proceedings show that at the time of the gifts and the creation of the alleged new partnership, "it was expected and anticipated that each of the partners, including the four minors, would be taxable on their shares of the partnership income" [R. 76, 139, 141], and that, failing realization of such purpose, it was not

intended that the children share in the partnership income as true owners of a capital interest in the partnership. This is made doubly clear by taxpayers' assertion that the incidence and result of the federal income tax liability, if the children paid no tax at all, was "insufferable and unintended," that the incidence and result if all shared in the tax burden in proportion to their partnership interests was "unsatisfactory" since to pay the federal and state taxes would take approximately all their earnings "while the four children grew rich" [R. 177-178], and that only the result achieved by the children paying all the additional tax was "most equitable". [R. 179.] At another point in his testimony, Parker acknowledged that if it had been "spelled out" at the time the gifts were made he (and his wife) would have had to pay the tax on the income he would have "immediately liquidated" and there would not have been any business to tax. [R. 75-76.] Obviously, then, there was no real intrafamily gift and no *bona fide* intent to form a business partnership. Rather, it appears from the facts of record that taxpayers' sole purpose in making the gifts and entering into the alleged partnership arrangement with their children was to obtain a tax benefit at the expense of the United States, without even an incidental business purpose. Certainly the taxpayers herein would not have entered into such an arrangement with strangers.

Conclusion.

The judgment of the District Court is correct and should be affirmed.

Respectfully submitted,

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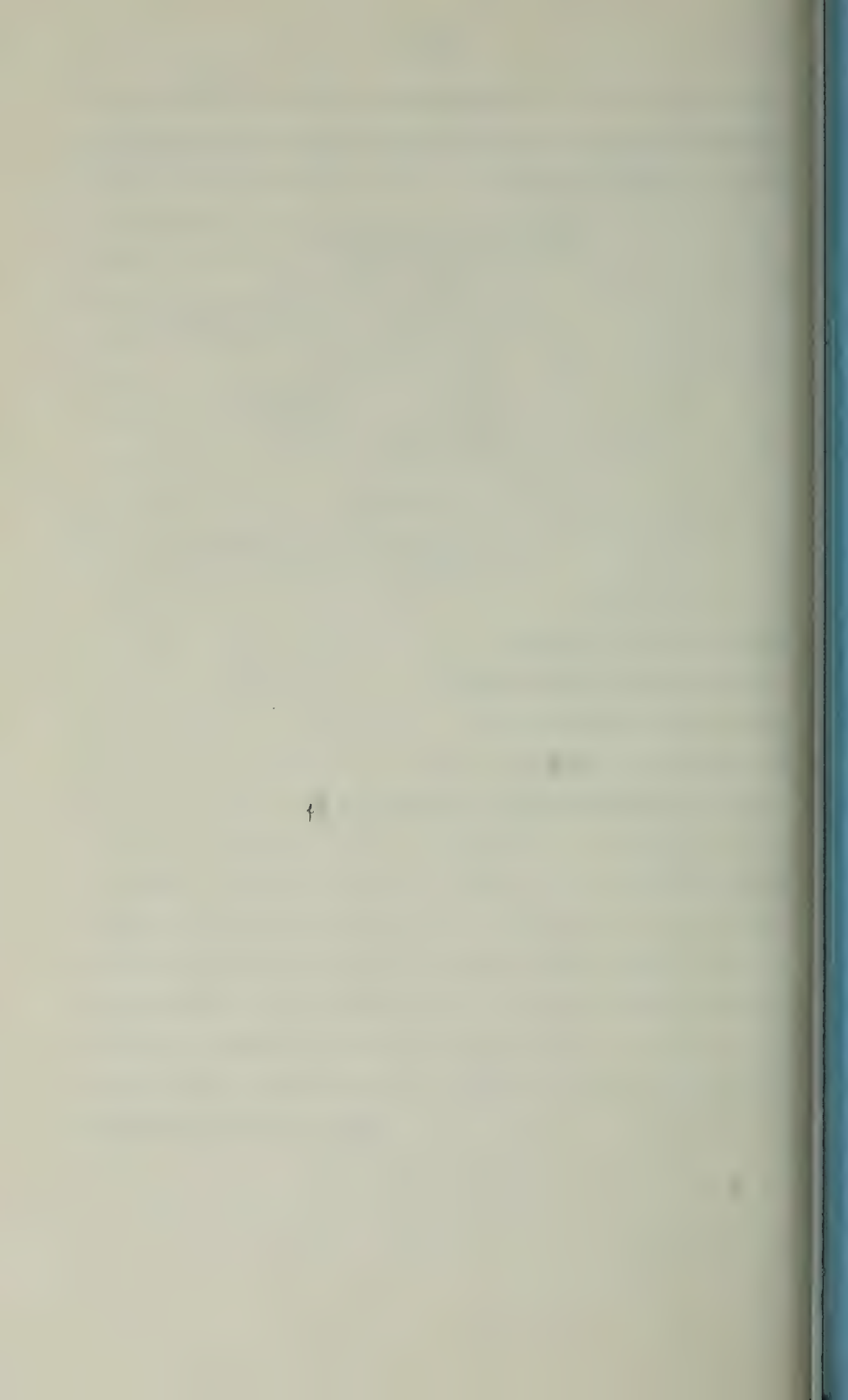
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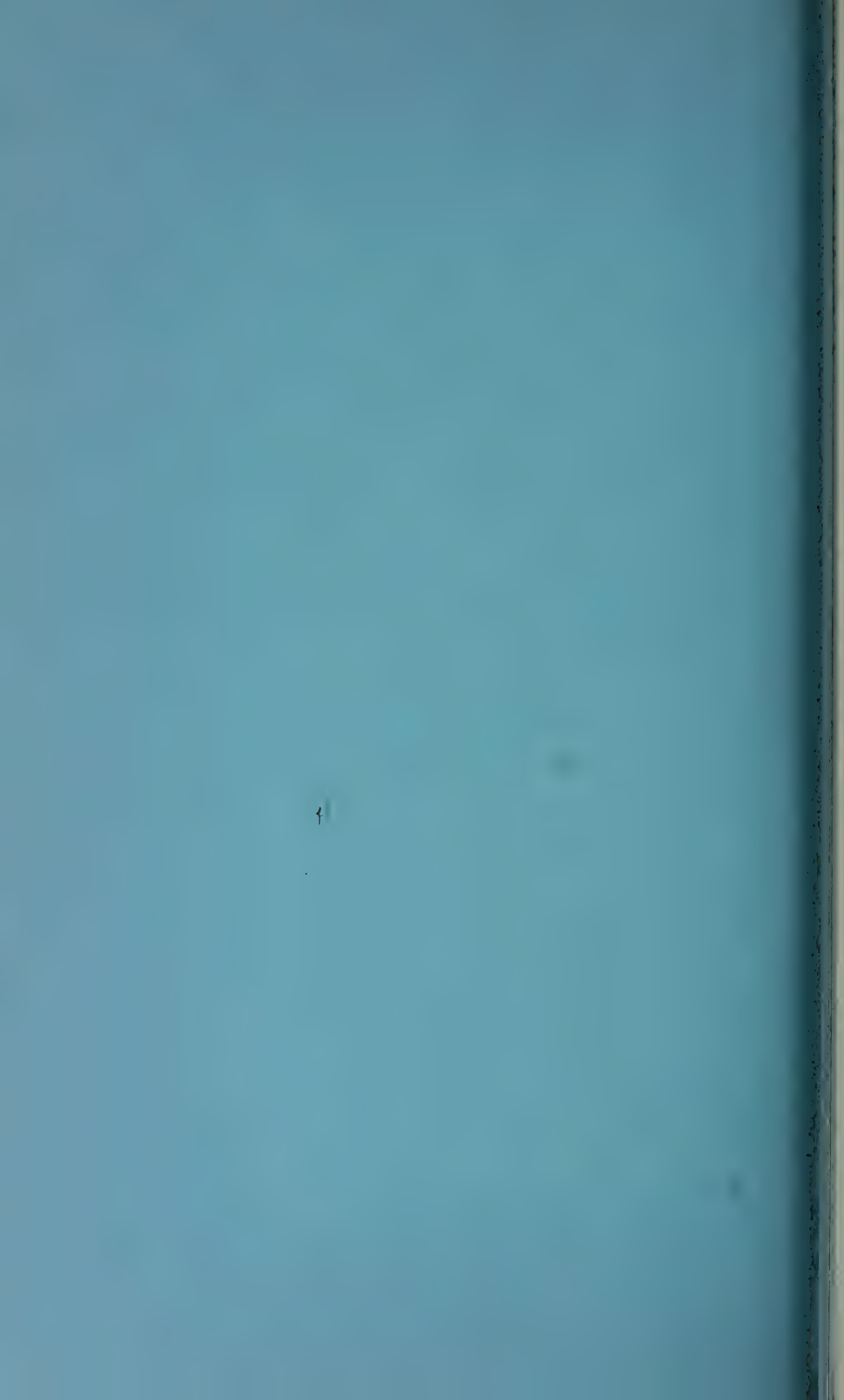
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May, 1957.





APPENDIX.

Internal Revenue Code of 1939:

SEC. 11. NORMAL TAX ON INDIVIDUALS.

There shall be levied, collected, and paid for each taxable year upon the net income of every individual
a * * * tax * * *.

(26 U. S. C. 1952 ed., Sec. 11.)

SEC. 22. GROSS INCOME.

(a) *General Definition.*—"Gross income" includes gains, profits, and income derived from salaries, wages, or compensation for personal services of whatever kind and in whatever form paid, or from professions, vocations, trades, businesses, commerce, or sales, or dealings in property, whether real or personal, growing out of the ownership or use of or interest in such property; also from interest, rent, dividends, securities, or the transaction of any business carried on for gain or profit, or gains or profits and income derived from any source whatever. * * *

* * * * *

(26 U. S. C. 1952 ed., Sec. 22.)

SEC. 181. PARTNERSHIP NOT TAXABLE.

Individuals carrying on business in partnership shall be liable for income tax only in their individual capacity.

(26 U. S. C. 1952 ed., Sec. 181.)

SEC. 182. TAX OF PARTNERS.

In computing the net income of each partner, he shall include, whether or not distribution is made to him—

* * * * *

(c) His distributive share of the ordinary net income or the ordinary net loss of the partnership, computed as provided in section 183(b).

(26 U. S. C. 1952 ed., Sec. 182.)

SEC. 3797. DEFINITIONS.

(a) When used in this title, where not otherwise distinctly expressed or manifestly incompatible with the intent thereof—

* * * * *

(2) *Partnership and partner.*—The term “partnership” includes a syndicate, group, pool, joint venture, or other unincorporated organization, through or by means of which any business, financial operation, or venture is carried on, and which is not, within the meaning of this title, a trust or estate or a corporation; and the term “partner” includes a member in such a syndicate, group, pool, joint venture, or organization.

* * * * *

(26 U. S. C. 1952 ed., Sec. 3797.)

Treasury Regulations 111, promulgated under the Internal Revenue Code of 1939:

Sec. 29.22(a)-1. *What Included in Gross Income.*—Gross income includes in general compensation for personal and professional services, business income, profits from sales of and dealings in property, interest, rent, dividends, and gains, profits, and income derived from any source whatever, unless exempt from tax by law. (See sections 22(b) and 116.) In general, income is the gain derived from capital, from labor, or from both combined, * * *.

* * * * *

No. 15340

IN THE

United States Court of Appeals

FOR THE NINTH CIRCUIT

ELGIN R. PARKER and FLO PARKER,

Appellants,

vs.

HARRY C. WESTOVER, individually and as Former Collector of Internal
Revenue for the Sixth District of California,

Appellee.

ELGIN R. PARKER and FLO PARKER,

Appellants,

vs.

R. A. RIDDELL, District Director of Internal Revenue, Los Angeles,
California,

Appellee.

On Appeal From the Judgments of the United States
District Court for the Southern District of California.

REPLY BRIEF FOR APPELLANTS.

MELVIN D. WILSON,

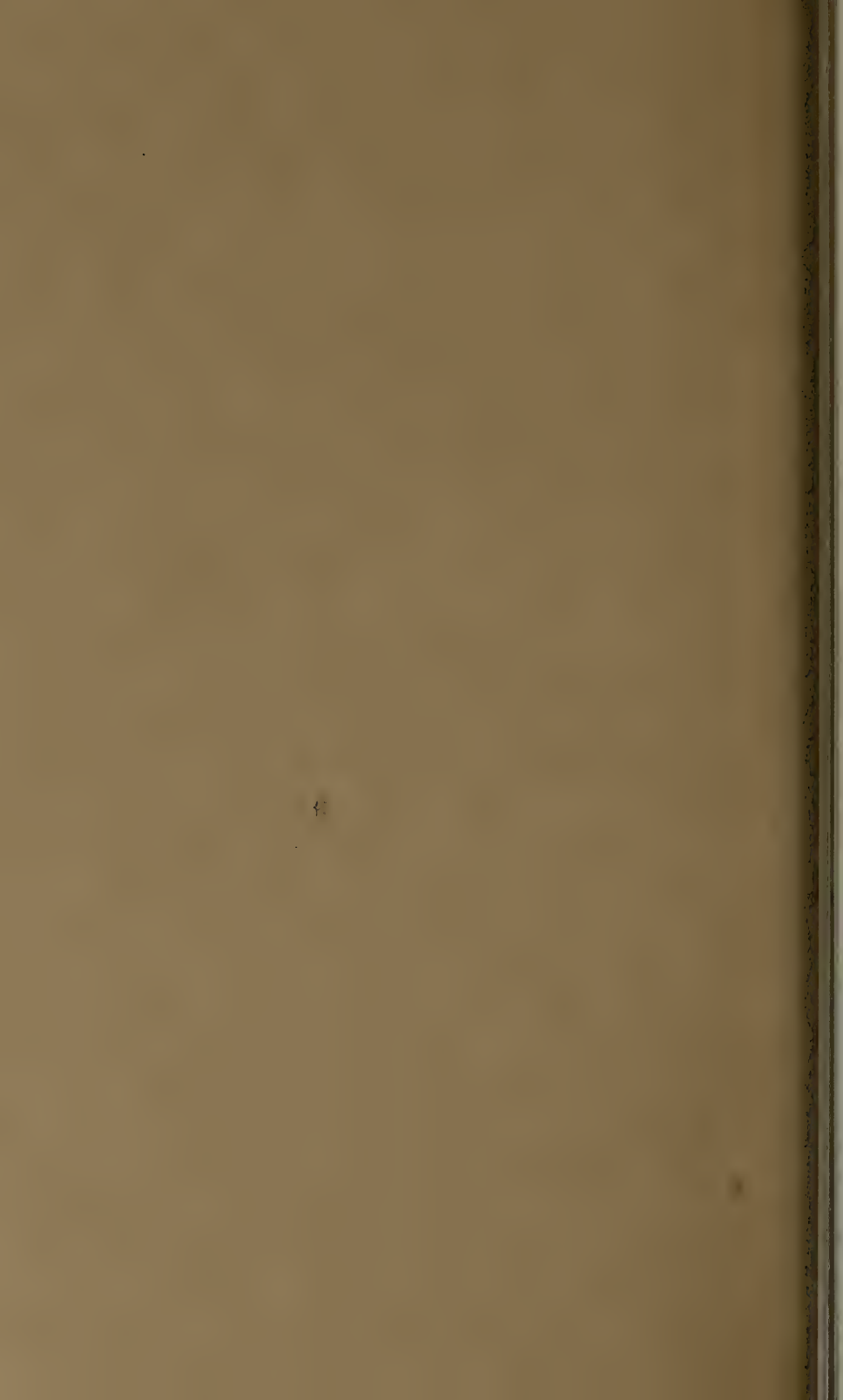
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On Appeal From the Judgments of the United States District Court for the Southern District of California.

REPLY BRIEF FOR APPELLANTS.

ARGUMENT.

I.

The District Court's Findings Constitute Mere Fiat.

Appellants' opening brief demonstrates that the real views of the District Court were completely different from the formal findings he signed at the instance of the Appellees.

II.

**Vital Services Can No Longer Be Argued as
a Prerequisite to Good Faith.**

The Appellees argue on pages 12 and 13 of their brief that the record amply supports the District Court's findings and conclusions that the parties did not intend to join together in the present conduct of an enterprise and that such factual conclusion may not be disturbed upon appeal unless clearly erroneous.

When the facts in the case at bar and the law applicable to the case are considered, it will be seen that the court below simply made statements which, if considered as fact finding, were mere fiatting, and if conclusions of law, were completely erroneous.

On page 13 of their brief the Appellees argue that the absence of intent to make the children partners is shown by the fact that none of them rendered any vital services.

The Appellees also state, which is a fact, that Flo Parker never contributed any services, yet they have recognized her as a partner throughout.

This Court, in *Pike v. United States*, 231 F. 2d 688, 693, said:

“While the record fails to show any such management activity on her (the Trustee's) part, either individually or as Trustee, in the operations of this partnership, yet, as we said in *Snyder v. Westover*, supra, ‘the absence of services is not determinative’.”

III.

**Original Capital Can No Longer Be Argued as
a Prerequisite of Good Faith.**

On pages 14 and 15 of their briefs the Appellees argue that there was no contribution of capital of which the children were the true owners.

Appellees state that Elgin R. Parker started with "little capital" and that the capital invested in the business October 31, 1943 was \$193,000. Actually, nowhere in the record is it stated that Elgin R. Parker started business in 1938 with "little capital". He said that he bought the business with savings, a gift from a relative, and on time. He did not say that he did not use borrowed capital at that time. On page 79 of the record he stated that the business did not borrow any money in 1943, 1944 or 1945, other than, of course, current liabilities. Plaintiff's Exhibit No. 58 [R. 164] shows that as of October 31, 1943, the current liabilities were \$113,500, so that the total capital involved was \$311,578.20 rather than \$193,000.

In *Pike v. United States, supra*, the lower court found there also that the "income was all attributable to the services of the plaintiff, Thomas P. Pike, and that neither the wife nor the children contributed capital or services for the production of income". The court, at page 693, said:

"The importance of capital in the accumulation of earnings of the partnership is plain when it is noted that as appears from the pre-trial order the overhead costs chargeable to Pike & Associates alone in the year of 1945 amounted to \$22,686.00. In some months the cost of sales for the month ran as high as \$100,000. The exhibits show that at the end of

the fiscal year ending January 31, 1945 the partnership had \$173,000 outstanding in accounts receivable. It was testified that this was because of the lag in collecting for work done."

Even at November 1, 1943, the Southern Heater Company had cash on hand of \$48,000, accounts receivable \$64,000, inventories \$83,000, land, building, machinery, equipment, shop tools, dies, furniture and fixtures and delivery equipment \$103,000, other assets \$12,000, or a total of \$311,000. It is obvious that no manufacturing business can operate without having equipment and a place in which to work, money to invest in inventories, money to operate the business until sales proceeds can be collected, etc.

Whether these assets were purchased with invested capital or borrowed capital is in a sense immaterial, but it is obvious that capital is needed to operate a business.

Plaintiff's Exhibit No. 63 [R. 168] shows that the average iron, steel and products manufacturing corporation in the United States had a net worth of \$1,831,800 in 1945 or 55% of sales. Likewise, the average nonferrous metals and products manufacturing corporation had a net worth in 1945 of \$1,179,000, or 57% of sales. Southern Heater Company's 1945 net worth of \$400,298, or 25% of sales, was definitely required in the business. Everyone knows that capital is required to organize and carry on business and the income of the business is attributable not only to the services of the managers and employees, but also to the capital of the company.

The entire record conclusively shows that the children were the true owners of the capital which was given to them and which was accumulated to their credit on the books of the partnership.

On pages 16 and 17 of their briefs the Appellees argue that not much credit can be given to the children's alleged gift capital.

This Court, in *Parker v. Westover*, 221 F. 2d 603, 606, in holding that the law of family partnerships had been changed since the trial for 1944, said:

"In 1945 and 1946 *the children invested capital* in the partnership by reinvesting a large share of their profits. . . . The amendment simply means that capital contributions derived from an *inter-family gift* must now be regarded as a factor of *substantial weight* . . ." (Emphasis supplied.)

Consequently this Court does not agree with the Appellees that gift capital is given but scant weight.

The Appellees argue on pages 16 and 17 of their brief that Section 340 of the Revenue Act of 1951 is not to be considered in connection with this case for prior years.

This is the same point that the trial judge made in holding that the verdict for 1944 was *res judicata* for 1945 and 1946, but this Court, in *Parker v. Westover*, *supra*, page 607, overruled that point and said:

"This amendment to the Internal Revenue Code and the Congressional Committee Reports pertaining to it should have been taken into consideration by the lower court. . . . The principles set forth therein were recognized by the Bureau of Internal Revenue, Mimeograph 6767, Cumulative Bulletin 1952-1, pages 111, 116, 117, under the heading 'Motive and Business Purpose'."

Consequently, the Appellees cannot restore the "original capital" and "vital services" arguments that were so erroneously accepted by many courts prior to the decision in *Commissioner v. Culbertson*, 337 U. S. 733.

On page 8 of their brief the Appellees argue that the retained earnings cannot be attributed to the children until it is shown that they were the real owners of the assets. In making this argument the Appellees overlooked the point that the children were bona fide partners and owners of the business assets for California law purposes. It may be that the earnings will be taxed to the parents under federal law, but nevertheless the money and assets represented by them belong to the children under California law and when left in the business constitute original capital contribution by the children.

IV.

The Children Participated in Management Through the Guardian and the Court.

On pages 18 and 19 of their brief the Appellees argue that the children had no participation in the management or control.

Here, again, the Appellees and the lower court ignored the pronouncements of this Court as to the effect of the gifts to the children, the appointment of a guardian, the supervision of the guardian by the Superior Court and the law of fiduciary relationships affecting the children's property.

In *Toor v. Westover*, 200 F. 2d 713, 715, this Court, in discussing the lower court's statement that the transfer of part of the business assets to the Trustee made no change in the control of the business, said:

“We are unable to agree that the creation of the limited partnership made no change whatever in the control exercised by appellant over the business. We believe there is a basic difference between control exercised with unlimited discretion solely for one's

personal benefit and control exercised only in a fiduciary capacity as a general partner in a limited partnership. See California Code, Sec. 15,509; 20 Cal. Jur., Partnerships, Section 44. This principle has now been recognized by the Treasury Department, Mimeograph 6767, 1952-1 Cumulative Bulletin 111”

When the District Court in the case at bar held that Elgin R. Parker continued to exercise sole control over the operation of Southern Heater Company, the court was violating the fundamental principle that the decision of a Circuit Court is binding upon the District Courts in the circuit. See *E. Edelman & Co. v. Triple A Specialty Company*, 88 F. 2d 852, 853 (C. A. 7, 1937), certiorari denied, 300 U. S. 680; *Palmer v. Bender*, 49 F. 2d 316, 324, affirmed, 57 F. 2d 32, affirmed, 287 U. S. 551; *Parker v. United States*, 125 Fed. Supp. 731, 733; *Morrone v. Southern Pacific Co.*, 72 Fed. Supp. 285; *In re Imperial Irrigation District*, 38 Fed. Supp. 770, 773, affirmed; *Wells Fargo Bank and Trust Company v. Imperial Irrigation District*, 136 F. 2d 539, certiorari denied, 321 U. S. 787. In fact, throughout the District Court's decision it is obvious that it has completely ignored and disregarded the several recent decisions of this Court on family partnership matters, including the decision of this Court on the *res judicata* point that there had been a change in the climate relative to family partnerships. See its decision [R. 31 to 33] and consider the pronouncements of this Court in *Toor v. Westover*, 200 F. 2d 713, *Snyder v. Westover*, 217 F. 2d 928, *Commissioner v. Edward D. Sultan*, 210 F. 2d 652, *Commissioner v. Thomas H. Brodhead*, 210 F. 2d 652, *Commissioner v. Roy Eaton*, 210 F. 2d 753, *Pike v. United States*, 221 F. 2d 603.

V.

The Children Enjoyed Their Income and Capital.

On page 20 of their brief the Appellees argue that unless Parker instituted proceedings, the children could neither withdraw from the partnership nor receive actual distributions of income from the business.

This is contrary to the law, since the Superior Court supervising the guardian could have ordered distributions or dissolution of the partnership even though the guardian did not acquiesce therein.

On page 20 of this brief the Appellees further argue that the children did not enjoy the fruits of their partnership. The facts show that in 1948 the partnership was dissolved and the partnership assets were completely distributed to the guardianships and the adult partners. The facts further show that since that time two of the children have become of age and have received their shares of the assets outright, free of their parents' control. The other estates are being held by the guardian under bond subject to supervision of the court and will be distributed when the wards become of age. The Appellees say on page 20 that the Parkers remained the substantial owners of the interests purportedly given away and cite *Toor v. Westover*, 200 F. 2d 213. That decision says that holding property in a fiduciary capacity is far different from holding it for one's self.

On page 20 of their brief Appellees claim that there was no change in the economic condition of the parents. The Commissioner did not see the matter this way when he accepted the gift taxes made by the parents on the 1943 transfers. In fact he increased them by determining that the business had a valuable good will and that the parents had given the children interests in the good will.

VI.

The Usefulness of the Children's Capital in the Business Is Adequate Business Purpose.

On page 24 of their brief, Appellees argue that there was no business purpose for making the gifts to the children and making them partners and hence the business purpose tests as set forth in Mimeograph 6767 are not satisfied.

The point that the children became general partners and hence their interests would be subject to the risks of the business, is fully answered in the Appellants' opening brief page 15.

On page 21, of their brief, Appellees cite *Hash v. Commissioner*, 152 F. 2d 722 as authority for the proposition that the desire of inducing the children into the business is a *personal* purpose rather than a *business* purpose. That decision does not so hold. On the contrary *Nicholas v. Davis*, 204 F. 2d 200 said that the purpose of benefiting the children was "a legitimate and commendable business purpose." A close analysis of the decisions of this Court in *Pike v. United States*, 231 F. 2d 288 and *Snyder v. Westover*, 217 F. 2d 928 will show that the only purpose there was to benefit the children. Still the purposes in those cases were held to be business purposes.

On pages 21 and 22 of their brief, Appellees refer to *Smith v. Westover*, 237 F. 2d 201 as setting forth a "similar situation". But in *Smith v. Westover* the partnership agreement provided that the majority in interests should control and in case of a tie, Jack Smith, the father, should have the last word. This was true with respect to practically everything and he had the right to purchase the interests of a deceased terminating partner at book value. Therefore, when the trial court held

in the *Smith* case that the father retained control and that there was no judicial control of the interests (the father being trustee for the trust created by the wife and the wife being trustee for the trust created by the father), the findings were not in error. The same trial judge decided that case also, but distinguished it from the case at bar when on page 182 of the Record he said:

“Each of these cases has its own peculiarities, which have to be considered. There are many elements which have developed in trial which did not exist in some of the other cases. Perhaps one of the most significant is that there is no general power such as existed in some of the others, of the managing partner to terminate the partnership or make disposition of the profits except in accordance with the general partnership agreement.”

Again on page 186 of the Record, the trial judge in the case at bar said:

“There are many elements present in some of the other cases, some of which, I, myself, have decided, which simply are not present here. One of the most significant ones is that except through failure the father had no way of milking the business, as it were, or even of exacting unreasonable compensation for his services or forcing a sale. All the conditions were equal. Whatever right he had, the others had.”

In the *Smith v. Westover* case there was no judicial control but in the case at bar the lower court [R. 186] said:

“It is true in a sense he dealt with himself, but even the probate court, exercising its advisory duties in a most cursory manner could not have allowed, under the wording of the partnership agreement,

following the gift, any of the exploitations of the estate of the type which was present in some of the other cases.”

On pages 22 and 23 of their brief, the Appellees argue that the parents had to borrow the children's tax refunds and borrow other moneys from the partnership and that this indicates that there was a tax avoidance motive. The Appellees argue that at the time of the gift and at the creation of the partnership, it was expected that if the children were not held to be taxable on their income from the partnership, they would not share in the partnership income as true owners of their capital interests in the partnership.

A similar situation was present in the case of *Pike v. United States*, 231 F. 2d 688. This Court there said the problems that such borrowings gave rise to were questions of state law. The Court said:

“Moreover, the circumstances of this borrowing has such slight bearing upon the main question of good faith, intent and business purpose in organizing the partnership that they cannot in our opinion alter our determination of these questions.”

The principle of restitution was sought to be applied in the *Parker* case wherein the parents made contingent claims against the guardianship estates for restitution of the refunds if the parents eventually lost their cases, and perhaps further equalization of the tax burden. The Parkers had no thought about this at the time the gifts were made but it eventually appeared that if they were going to have to pay income taxes on the total partnership income, there would have to be some adjustment of the distribution of that income.

The Appellees say on page 24 of their brief that Mr. Parker stated, after the Commissioner had assessed all the tax on the partnership income to him and Mrs. Parker, that if he had known that would be the eventual result he would have liquidated the partnership. The Appellees seem to think that this indicates that there was no bona fide original gift to the children.

It is obvious that with the present high tax rates, no one can pay the income tax on another's income and survive. If one of the Justices of this Court should step down and commence the practice of law, say with an adult son who was already in the practice of law and earning \$25,000 per year, and they agreed to divide the earnings equally and they each thereafter earned \$100,000 and the Commissioner taxed \$175,000 to the father, undoubtedly the father would have to terminate the partnership, as to pay taxes on his son's income would be "insufferable and unintended and unsatisfactory and inequitable." Any one would terminate such a partnership even though it were with a child. Mr. Parker testified that the gifts were outright [R. 75], and the entire course of conduct since Oct. 31, 1943, shows that they have been so treated.

The parents made gifts to their children of interests in business assets to give them some security should the parents, through personal and outside speculations, again get into straitened circumstances. These gifts were absolute and unconditional. On such gifts, gift taxes were paid and retained. The children's assets were required in and useful to the business. The parents were adequately compensated for the services they rendered to the partnership. The children's assets and income were fully protected by the probate court supervising

the guardianships. The adult children have taken their assets into their own hands. The good faith of the partners has been established, through their conduct for fourteen years. The children really and truly owned their interests in the business, and all parties intended to operate the business together. The income from the children's assets should be taxed to them, and not to the parents.

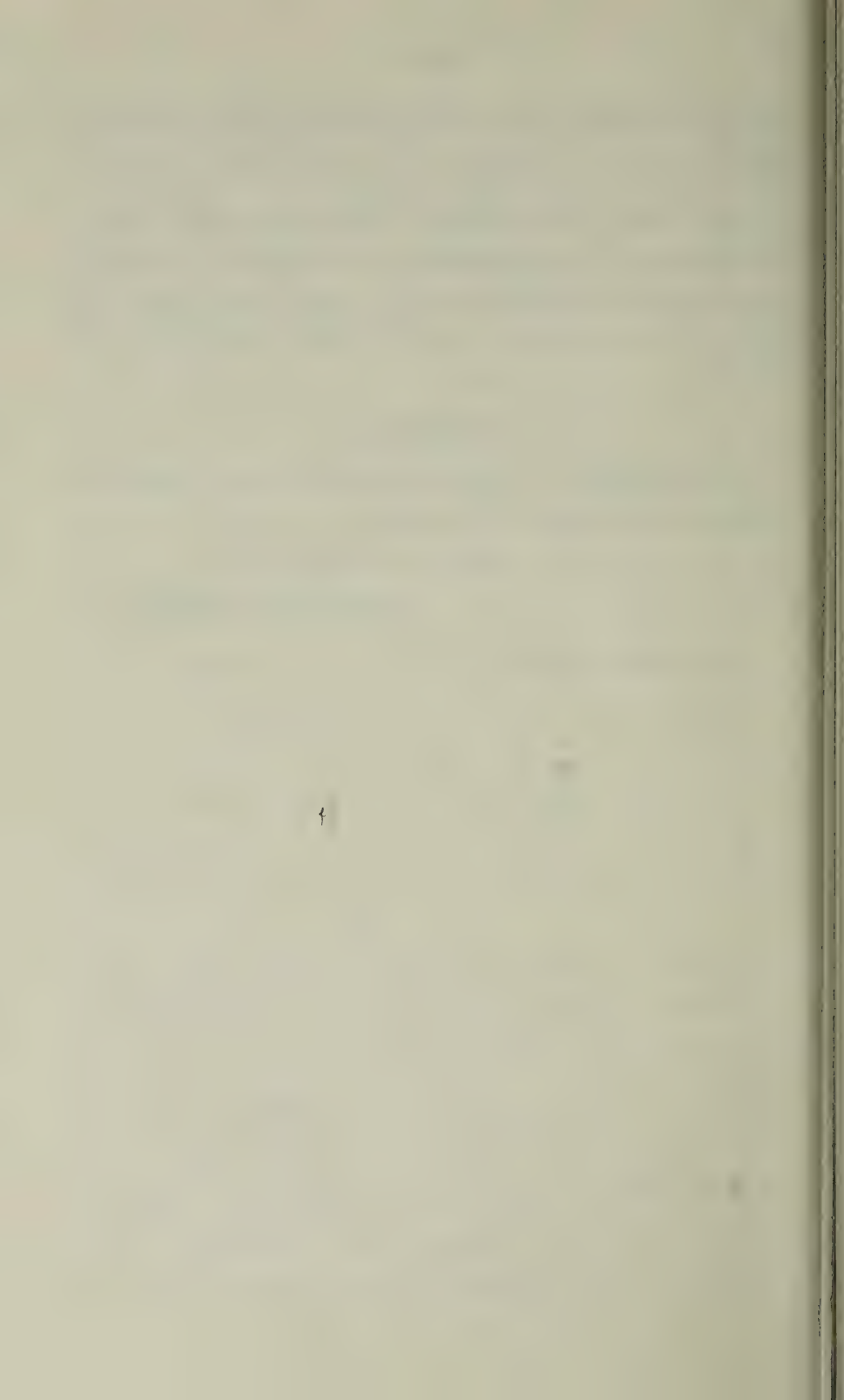
Conclusion.

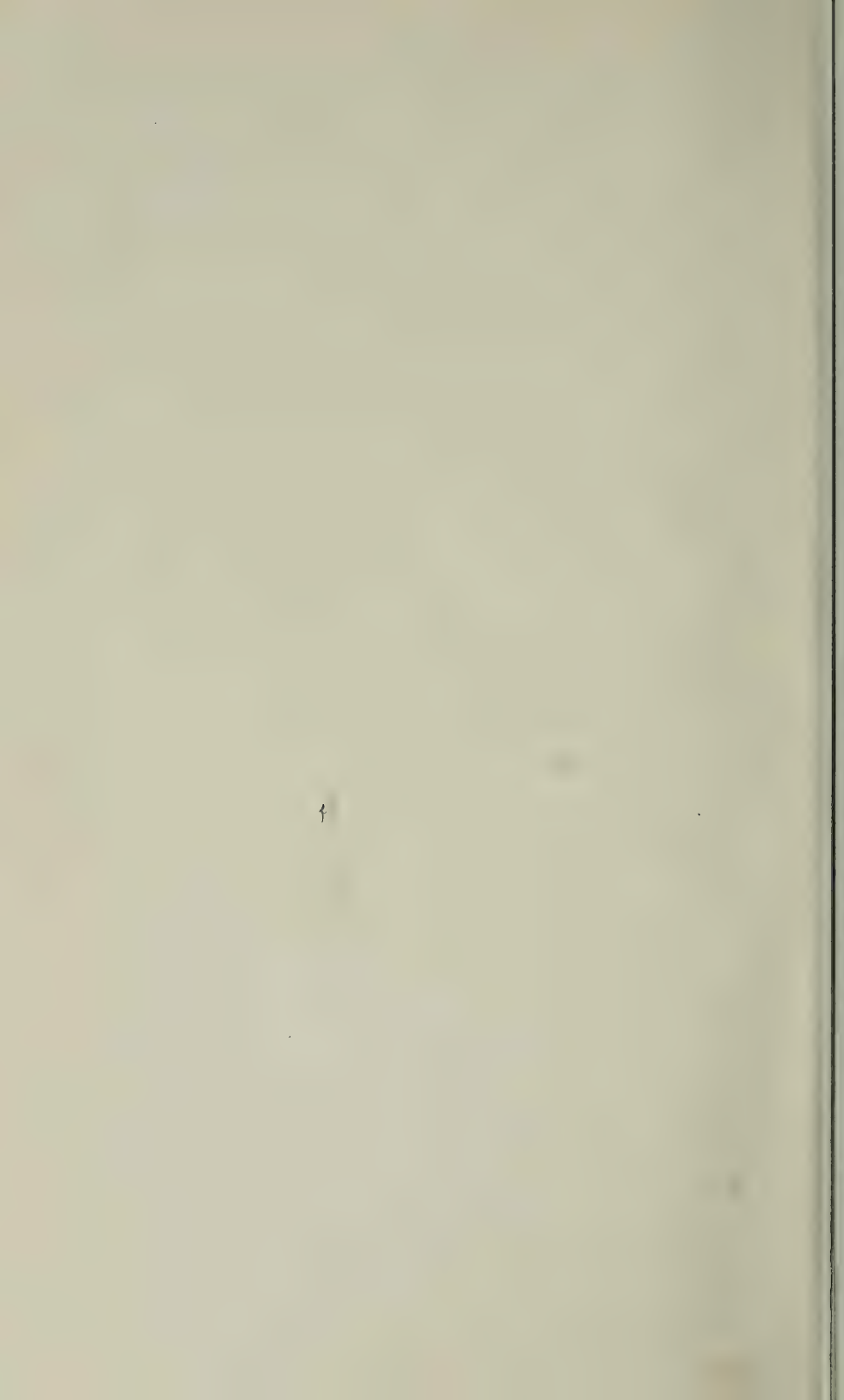
The judgments of the District Court are completely erroneous and should be reversed.

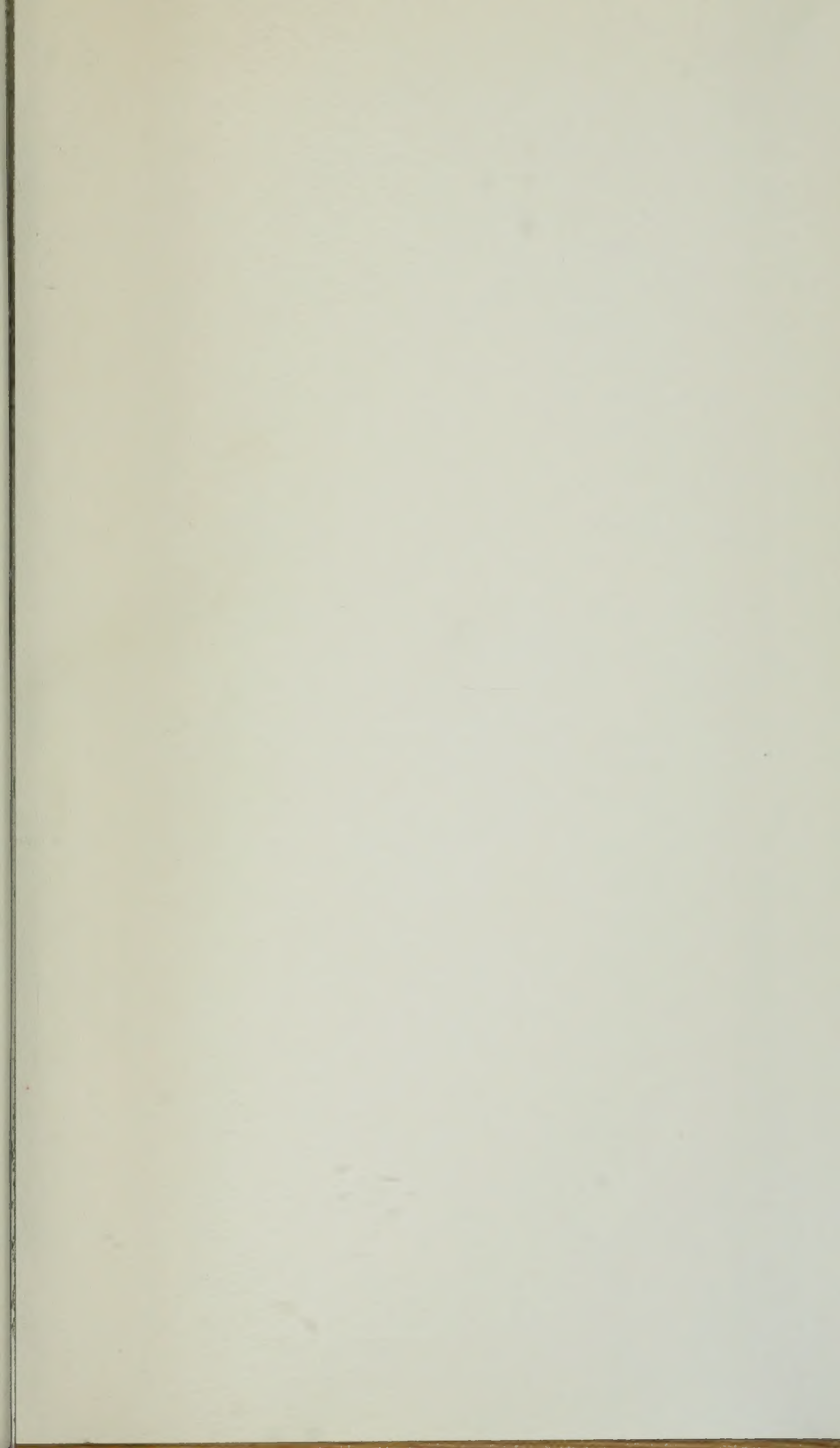
MELVIN D. WILSON,

Attorney for Appellants.

Dated: May 16, 1957.







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